# HISTORY

OF

# INDIAN CURRENCY AND EXCHANGE

B. E. DADACHANJI



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# HISTORY OF INDIAN CURRENCY AND EXCHANGE

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# HISTORY
# OF
# INDIAN CURRENCY AND EXCHANGE

BY

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*"A Reserve Bank for India and the Money Market"*

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TO

THE MORRIS COLLEGE STUDENTS

THIS BOOK

IS DEDICATED

## PREFACE TO THE SECOND EDITION

The author is largely indebted to the many Professors of Commerce and Arts' Colleges of Indian and some Foreign Universities for the warm welcome accorded by them to the first publication. Indeed, he is under a particular obligation to them for having offered many excellent suggestions and criticisms which were calculated to improve the book. For instance, the Professors of many American Universities have suggested the inclusion of a preliminary explanation on the peculiarities of the Indian Foreign Exchange as a basis for a clear understanding of the evolution of the Indian currency mechanism. With much pleasure their suggestion has been carried out. Requests have also been made to embody the subject of the Indian Banking System in this book. But as the subject is exhaustively dealt with in the Author's recent publication—"*A Reserve Bank for India and the Money Market*", an apology from the Author for disappointing these friends will, it is hoped, be kindly accepted by them. All other minor suggestions from other friends have been included and thus the wishes of these too have been complied with. Happily, the book has a wide share of its use in Japan, and to bring it within the scope of the Universities teaching purely in the Japanese language, a Japanese translation has been mooted.

In this second edition the plan of the book remains unchanged. Some chapters have been added to bring the history up-to-date; some have been divided and modified, while in others the subject-matter has been rearranged. Commentaries, too, have been added to clear certain points. Hence, if its indulgent readers overlook its deficiencies, as

they have done previously, the author will consider himself greatly rewarded.

It only remains to say that in the preparation of the second edition, the writer takes pleasure in acknowledging his great indebtedness to his colleague, Professor A. C. Sen Gupta, M. A., I. E. S., for his very scholarly comments and suggestions. The writer's special thanks are due to the Rev. Father A. J. S. Monteiro of St. Francis de Sales' High School, Nagpur, for his advice and invaluable help given in various ways. Finally he is also grateful to his former pupil, Mr. V. V. Prayagi, B. A., for preparing the diagrams and rendering general assistance in preparing the manuscript.

August 17, 1931. **B. E. D.**

## PREFACE TO THE FIRST EDITION

This book on the *History of Indian Currency and Exchange* has been specially written with the object of meeting the requirements of students preparing for the *B. A. and B. Com. examinations* of Indian Universities. It, therefore, presupposes the knowledge of the general principles of Currency and Exchange. The plan adopted of treating the subject is very simple and is designed to elucidate the different phases of the Indian Currency System. Its chief aim is not to stuff the students' minds with facts and figures, but to create in them a genuine taste which would lead them to a methodical study of the chaotic history of Indian Currency.

My debt to various authorities on the subject and to the Blue books mentioned in the Bibliography cannot but be acknowledged by me. In the case of the latter, which form the real basis of the work, their original language has been adhered to, wherever necessary, to indicate the source of information.

I am indebted to my colleague, Professor A. C. Sen Gupta, M. A., I. E. S., for his very valuable suggestions, and to Professors Chordia and Ghose for the help they gave in correcting the proof-sheets.

Despite its imperfections, it is sincerely hoped that the book will prove useful to students and form the foundation for further study.

Morris College,
*Nagpur: June 25, 1927.*

B. E. D.

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## CHAPTER III.



# Book II.

## Indian Currency History during the Twentieth Century.

## CHAPTER IV.

## CHAPTER V.



## CHAPTER VI.

## EXPLANATION OF FIGURES

As a guide to the reading of the figures it may be mentioned that: —

100,000 rupees=1 *Lakh* rupees=£ 7,500.
(at the present rate of exchange.)

100 lakhs (10 million rupees)=1 *Crore* rupees=£ 750,000.
(at the present rate of exchange.)

# INTRODUCTION

## Special peculiarities of Indian Foreign Exchange.

For a clear understanding of the development of the Indian Currency System some knowledge of the peculiarities of the Indian Foreign Exchange is necessary. These peculiarities arise from factors which are almost unique and give to the Indian Foreign Exchange a character which at once distinguishes it from that of any other important trading country in the world. The one predominant characteristic that pervades these factors is the direct part which the Government of India plays in the currency and exchange system of India. In what way these transactions of the Government of India influence the Indian Foreign Exchange will now be shown.

### I. Chief imperfections of the standard of currency.

In the first place, the Indian Currency System has been since 1813 what is commonly, although mistakably called the "Gold Exchange Standard". Indian currency consists of two kinds of *token ;* (1) paper money and (2) silver coins, which are mutually convertible. Unlike other Governments, the Government of India issues *its own paper currency* and is the *sole supplier and direct controller* of both notes and silver rupees.

For keeping the value of the token currency (near a fixed par in relation to gold) the Government holds *two* Reserves : (a) the Paper Currency Reserve and (b) the Gold Standard Reserve. The former is composed of the proceeds of the note issue and is held as a backing against the notes in circulation ; whereas the latter has been built

out of the profits of the coinage of the silver rupees and has for its purpose the maintenance of the sterling (*i. e.* the exchange) value of the rupee. It is kept in England with the Secretary of State for India. As regards the Paper Currency Reserve, some part of it is kept in India in silver and securities and the larger part of it is kept in England in gold and securities.

It is an established practice of the Gold Exchange Standard that, in order to keep the local token currency near the gold parity with other countries, the *control of the foreign exchanges by the Government or a* Central Bank is necessary. All that is necessary is the power and ability of the authority to sell foreign exchange at a fixed price. *In India it is the Government that controls the foreign exchange.*

But the fact that needs the greatest emphasis is that up to 1927 India had *never* had the 'Gold Exchange Standard' except in name. The currency system in operation in India up to the outbreak of the Great War was not in fact more than a 'Sterling Exchange Standard'. Besides, during the War the rupee broke loose from its moorings and an unsuccessful attempt was made to stabilize it in 1920. Since then the fact remains true that India *had no currency standard at all.* In criticizing this feature the Royal Commission on Indian Currency and Finance, 1926, wrote, "The stability of gold value of the rupee is thus based upon nothing more substantial than a policy of the Government and at present that policy can be found defined under no notification or undertaking by the Government. It has to be implied from the acts of the Government in relating to the currency and those acts are subject to no statutory regulation or control." This deficiency the Currency Act of 1927 made good.

It enforced *a statutory obligation* upon the Government to maintain the rupee at the ratio to gold so fixed by *purchasing gold bullion* tendered for sale and by *selling gold or sterling* at the fixed parity of exchange. But even this Act has *not* established the Gold Exchange Standard in its perfect form.[1] However perfected this standard may be the danger inherent in it, that is, the danger of the rupee going out of circulation if the price of silver rose above a certain point, will always remain. Besides, the system does not secure the automatic expansion and contraction of currency. "Such movements", wrote the Royal Commissioners, "are too wholly dependent on the will of the currency authority".

In the absence of a Reserve Bank, with intimate and thorough knowledge of the day-to-day requirements of the money market of managing the currency and the reserve of the country, it is natural that expansion and contraction of currency cannot take place adequately. This therefore brings in a disturbing element in the foreign exchanges of India.[2]

### II. No co-ordination of credit and currency.

The second peculiar feature of the Indian foreign exchanges arises from the first. In other important trading countries a Central Bank is instituted which is given the monopoly of note issue, so that the banking and currency reserves are at once concentrated in a single institution and that harmony of relation which ought to exist between currency and credit is obtained. It is the single controlling hand of a Central Bank which gauges constantly and accurately the demand for money in the

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[1] For other defects of the Act see chapter VI, Period V.

[2] For other defects of the standard read chapter VI, Period IV.

country from time to time and is able to adjust its supply accordingly. When the supply of money and credit is adequately adjusted to the demand for them, that disturbing element in foreign exchanges resulting from their maladjustment does not exist. But in India the case is different. It is the Government that exercises direct control over currency both metallic and paper, and the very meagre control which exists over the credit organization of India is in the hands of the Imperial Bank of India, a joint stock bank which works as bankers to the Government. With divided control the equilibrium between demand for and supply of money is not obtained and the foundation for the establishment of a credit policy so essentially necessary for foreign exchanges does not exist. [1]

### III. Government is the largest dealer in foreign exchange.

The third and the most important peculiarity of the Indian Foreign Exchange arises from the remittance operations of the Government of India. They have to remit *annually* nearly *£35 millions* from India *to London* to the Secretary of State to pay for what are commonly known as the *Home Charges,* which are payments for loans contracted in England for the Indian railways and irrigation, the purchase of bar silver for Indian silver currency, stores purchased, pensions and furlough allowances, expenses of the High Commissioner's office etc. In this respect the Government is the *largest dealer* in the *Indian* foreign exchange.

(1) THE SYSTEM OF MAKING REMITTANCES EXISTING BEFORE 1923 :—Since India has had no gold currency or gold standard and the payment

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[1] This subject is developed in chapter VI. But for a fuller account of this subject read the Author's: *A Reserve Bank for India and the Money Market,* Chapter II.

for the Home Charges had to be made in *gold* in London, a system was evolved in order that this annual payment to the Secretary of State might not necessitate the actual buying of gold in India to be remitted to London. This system which existed *before 1923*, consisted in the *sales of "Council Bills" and Telegraphic Transfers by the Secretary of State for India in London*. The mechanism had the same effect as the sale of an ordinary bill of exchange. A simple example would make this clear.

Suppose X in England had bought goods worth £10,000 from Y in India. In the ordinary course X would either buy a bill of exchange through a broker or a bank and send it to his creditor Y or send actual gold to him. In either case, Y would have to get the Bill or gold exchanged *for Rupees*, the current coins of India.

At the same time, suppose the Secretary of State for India had to receive £10,000 from the Government of India towards the payment of the Home Charges. The Secretary of State for India (the creditor) drew a bill (called a "Council Bill" because it was drawn by the Secretary of State in Council) for £10,000 on the Government of India (his debtors) and sold it to X the debtor of Y, and like an ordinary banker or bill broker charged for cost and commission from X.

The Bill was an order asking the Government of India to pay to Y not £10,000 but the value of £10,000 *in terms of rupees at the then existing rate of exchange*. When the Government of India paid Y in so many Rupees it was equivalent to paying its debt of £10,000 to the Secretary of State. In this manner the Government of India discharged its obligation and also helped the foreign importers of Indian commodities to make remittance to their creditors here. Diagram A illustrates the mechanism :

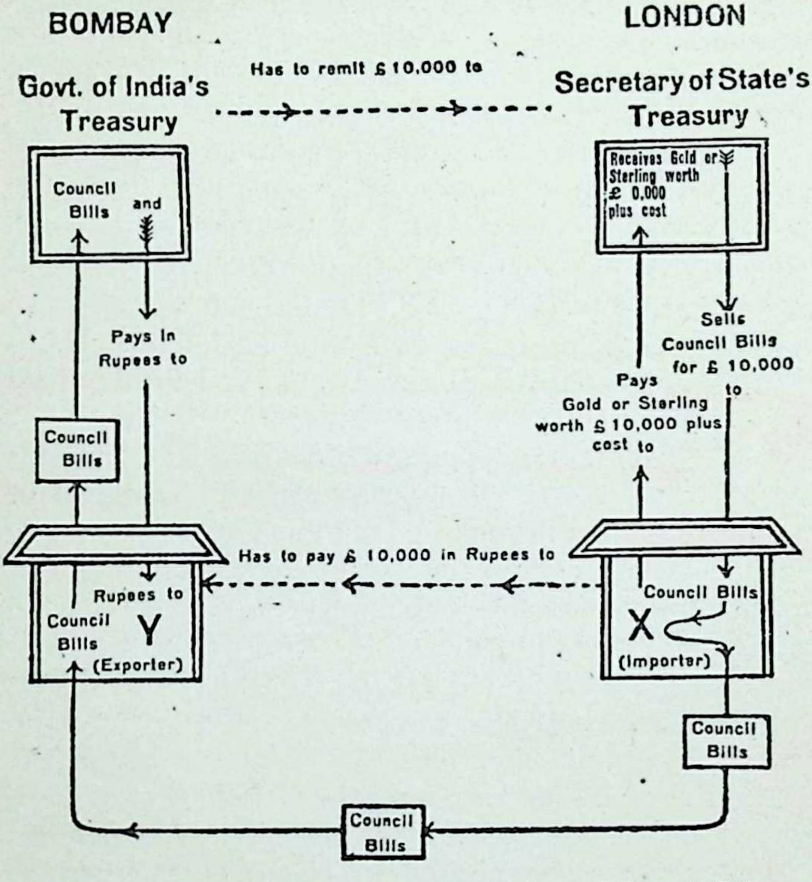



Diagram A—Illustration showing the working of Council Bills

If, however, as in the above example, X the debtor had to make *immediate* payment to Y, he would buy a *Telegraphic Transfer,* which was a Council Bill in a telegraphic form. Ordinarily it took a Council Bill fifteen days and more to reach India, so that the interest on the amount remitted for this period was thereby lost. If X wanted to save this loss, he bought a Telegraphic Transfer which empowered his agent in India to obtain his rupees from the Government of India Treasury within a few hours after the payment of the Sterling into the Secretary of State's Treasury. Thus a Telegraphic Transfer cost more than a Council Bill.

The allotment for Council Bills and Telegraphic Transfers was made to the highest bidder on Tuesday every week. But if they were demanded on other days of the week, "intermediate bills and transfers" were sold by the Secretary of State at a higher rate than that existing on the previous Tuesday.[1]

This system of the sale of Council Bills and Telegraphic Transfers was primarily adopted as a substitute for actual remittance of gold by the Government of India to pay for the Home Charges to London. But in course of time their use was extended and more Council Bills (than representing the total value of the Home Charges) were sold to afford facilities for payment to importers in England of Indian commodities. What other part these Bills played in the Indian Foreign Exchange will be shown shortly.

(2) THE NEW SYSTEM OF MAKING GOVERNMENTAL REMITTANCES SINCE 1923 :— However, since 1923 this method of the sale of Council

[1] For simplicity of exposition the details of the sales of the Bills and Transfers are omitted here.

Bills (and Telegraphic Transfers) by the Secretary of State has been more or less abandoned and is substituted by the system of *purchase of sterling in India*, sometimes by public tenders and at other times by private purchase.[1] This important change has been introduced because it is possible to do so owing to the existence of the Imperial Bank of India which works as bankers to the Government, although the Government has not ceased directly to operate in the exchange market. It is through the agency of this Bank that Sterling is purchased from the Exchange Banks (or foreign banks in India) and recognized firms.

The old method of sale of Council Bills was superseded for various reasons: (1) In the first place, in this method the Exchange Banks first used to purchase Sterling Bills in India and had them rediscounted in the London Money Market by their Head Offices, and with the amount so obtained they used to buy Council Bills and Telegraphic Transfers for their clients. This system was in practice found cumbrous and inconvenient to businessmen. (2) Secondly, it will be shown in the course of this volume that on many occasions the Secretary of State sold Council Bills at such times and at such rates that the Indian Money Market was adversely affected. (3) Thirdly, it always gave the Secretary of State undue power in the exchange market, which sometimes in practice subordinated the interests of the Indian Money Market to his own requirements.[2]

The new method of purchase of sterling in India is better than its predecessor for various reasons:

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[1] Since 1925 this new method has completely superseded the old.

[2] For a fuller discussion of this subject read the Author's: *A Reserve Bank for India and the Money Market*, Chapter VII.

(1) It is in India that the export bills originate and it is in the same country that the liability of the Government of India to remit money also arises. It is, therefore, natural that the sellers and buyers of bills can best meet each other in the same country. (2) Then, the factors which influence the immediate course of exchange can be judged more accurately and more promptly than in the old method. Besides, the purchases can be regulated according to the varying conditions of the Indian exchange market and the remittance operations can be conducted so as to avoid violent fluctuations in rates, and the consequent disturbances to the Money Market. (3) Further, by this method the initiative in making remittances and thereby fulfilling their liabilities is rightly given to the Government of India who ought, in principle, to be able to remit the Home Charges smoothly and economically.

As long as India has a favourable trade balance and there are enough surplus Bills for sale to pay for the Home Charges, both the old method of the sale of Council Bills (and Telegraphic Transfers) and the present one of the purchase of sterling in the open market prove successful. But in case there are some unfavourable circumstances existing, such as a failure of the monsoon, and exports fall off considerably and the balance of indebtedness goes against India, both these methods of remittance fail because in the case of the Council Bills (and Telegraphic Transfers) there would not be sufficient debtors to sell to, and in the case of the other method it would not be possible to purchase an adequate amount of sterling bills in India.

### IV. Government's Control of the rate of exchange.

In the system of Government remittance by "Council Bills" and their counterpart, the "Reverse Councils"

(which will be explained shortly) the Government found in course of years the best method of controlling the rate of exchange and thereby the standard of Indian Currency. By regulating the amount of the sale of these Council Bills (and Telegraphic Transfers) and the *Reverse Councils* as occasion required it was in a position to control the rate of exchange.

(a) HOW THE UPPER LIMIT OF EXCHANGE WAS CONTROLLED? (THE SALE OF COUNCIL BILLS) :—When normal conditions prevailed, Council Bills were sold by the Secretary of State up to the limit of the Home Charges. But *if the supply of sterling in India was greater than its demand,* its price was prevented from falling *i. e. the rate of exchange was not allowed to rise above* a certain point. This was done by selling *extra* Council Bills in London. The effect was obvious. When the *extra* Bills were encashed at the Government of India Treasury, so many more rupees were made to enter into circulation. That is, *expansion of currency* took place. *More rupees than before were forced into circulation with the same number of commodities as before,* with the result *that the exchange value of the rupee was artificially brought down.*

Suppose for instance, at a given time Rs. 150 crores were in circulation in India and it was found that the excess of supply of sterling in India over its demand was Rs. 1 crore. Then, the extra sale of Rs. 1 crore of Council Bills would increase the circulation to Rs. 151 crores and to that extent the rate of exchange was lowered. Diagram B illustrates this result.

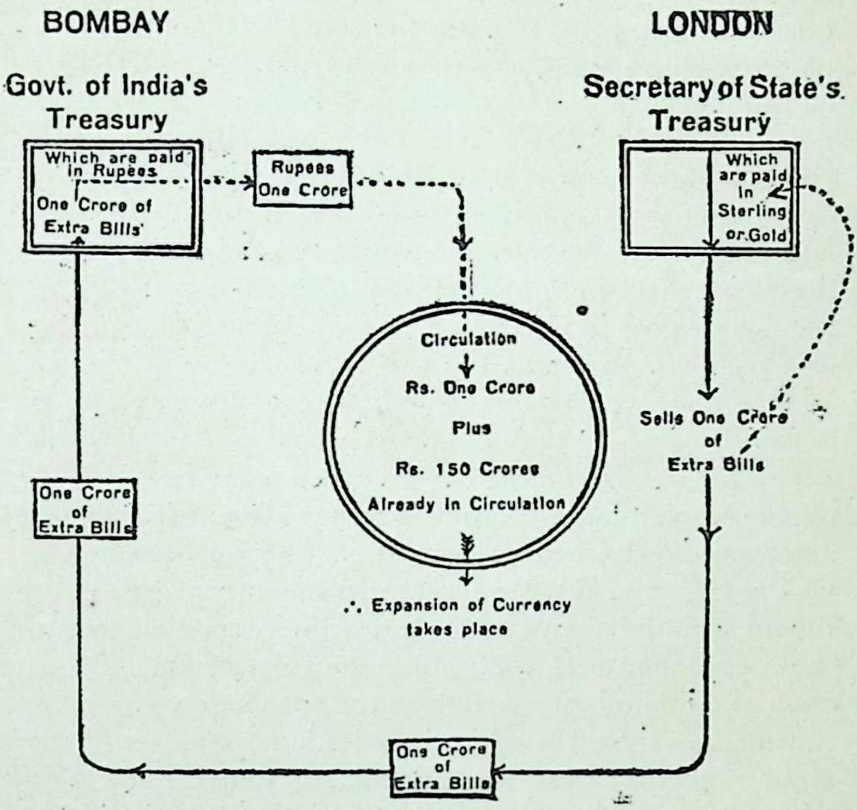



**Diagram B**—Illustration showing Expansion of Currency resulting from extra sales of Council Bills

This sale of extra Council Bills tended to produce another effect. It *prevented* Rs. 1 crore of *gold* from entering India and thereby helped the Government in bringing down the rate of exchange. Because, if this gold were permitted to enter the country, more gold than before would have exchanged with the same amount of rupees and the rate of exchange would have consequently gone up.

Another means was also resorted to by the Government of India at the same time. They began to *buy* the gold imported into India at a fixed price in rupees. This had the same effect of expansion of rupee currency and contraction of gold in circulation.

This, therefore, was the two-fold mechanism adopted in case *the exchange tended to rise above the specie-point*.

But the present method of purchase of sterling in India by the Government of India results in the expansion of currency *directly* because, when sterling bills are bought by the Government, they are paid for in rupees. These rupees are added to those already in circulation and all these exchange with the same number of commodities as before and thereby tend to keep the exchange value of the rupee *lower* than it would otherwise be.

(b) HOW THE LOWER LIMIT OF EXCHANGE WAS CONTROLLED? (THE SALE OF "RESERVE COUNCILS"):—On the other hand, when owing to the failure of the monsoon or some other adverse cause Indian exports fell off considerably and the balance of indebtedness went *against* India, the *demand for sterling would be greater than its supply* in India. In this case, the price of sterling was not allowed to rise i. e. *the exchange value of the rupee was not per-*

*mitted to fall below the lower specie-point.* This was achieved by the sale, *in India,* of Sterling Bills or "Reverse Councils". These are Bills sold in the reverse direction to "Council Bills", i. e. *they are drawn by the Government of India on the Secretary of State.*

Suppose X in India had to remit £10,000 to Y in London and at the same time the Secretary of State wanted to transfer £10,000 to India. If in the ordinary course X could not buy bills on London in the open market, he would purchase "Reverse Councils" worth £10,000 from the Government of India drawn in favour of his creditor Y and send it on to him. Y on his part would present it to the Secretary of State's Treasury and would receive sterling worth £10,000. Thus, by the purchase of "Reverse Councils" the buyers in India pay in Rupees and make remittances in Sterling to London, and by their sale the Secretary of State is able to remit £10,000 to India. Diagram C explains this in a simple form.

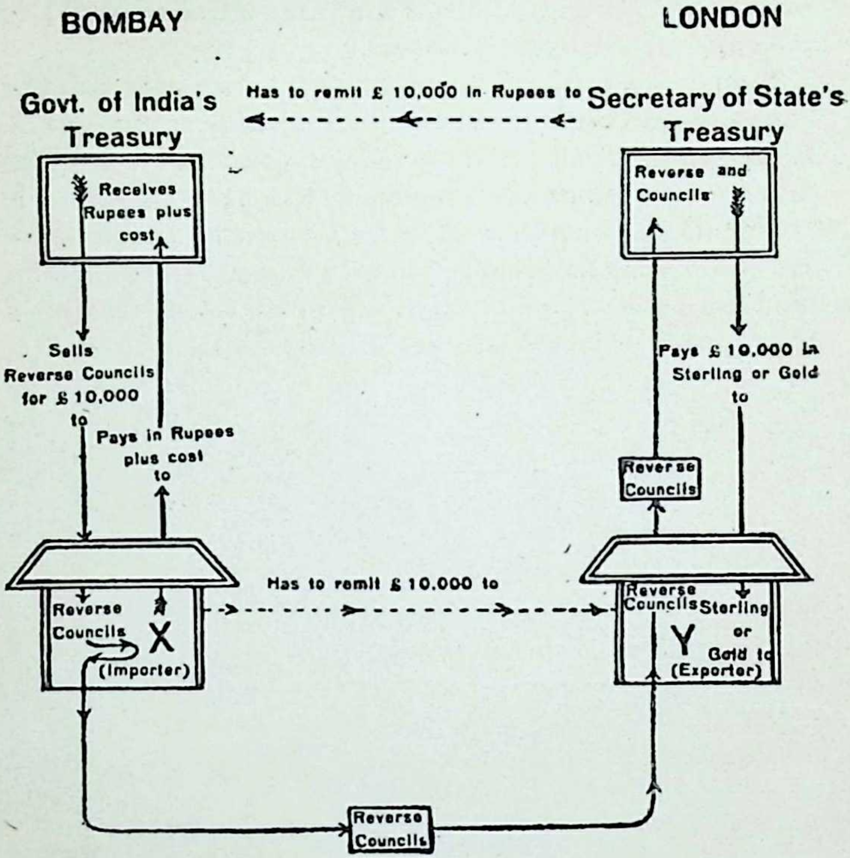



Diagram C — Illustration showing the working of Reverse Councils

But when the Government of India sells "Reverse Councils", they are paid for by the buyers *in rupees*. In this way rupees are withdrawn from circulation and *contraction of currency* is effected and *the exchange value of the rupee is accordingly raised.*

Suppose, as in the above example, there are Rs. 150 crores in circulation, when the exchange value of the rupee tends to fall below the specie-point and it is found necessary to reduce the amount by Rs. 1 crore by the sale of Reverse Councils. The result would be to leave Rs. 149 crores to circulate with the same number of commodities as before, tending to raise the exchange value of the rupee. This is explained in Diagram D.

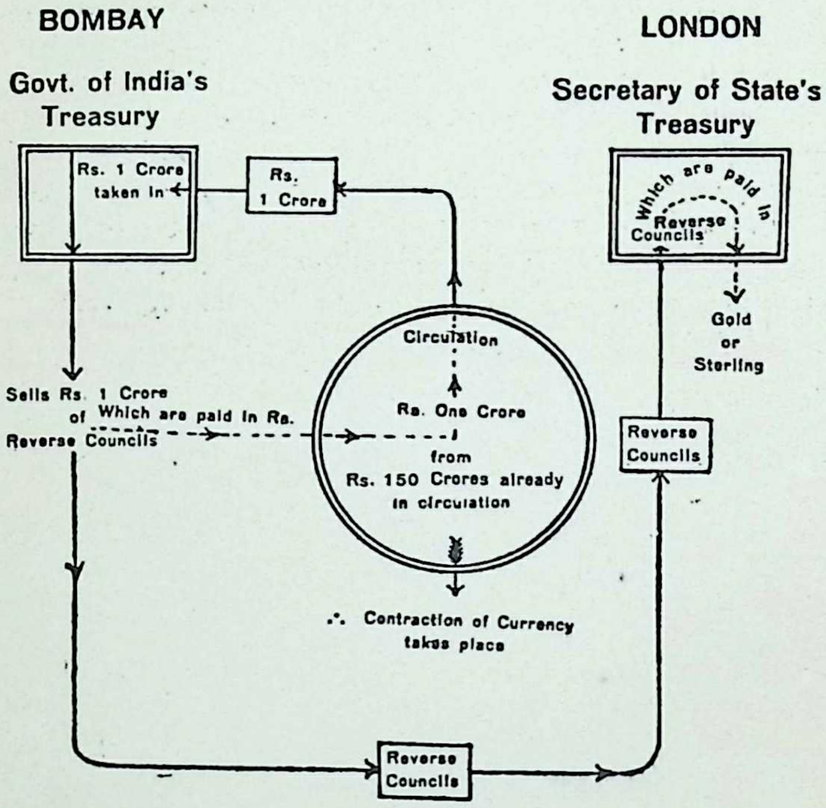



**Diagram D**—Illustration showing Contraction of Currency resulting from sales of Reverse Councils

Besides, in order to prevent the exchange from falling below the specie-point the Government of India adopted another measure. Before Gold sovereigns were demonetized by the Currency Act of 1927, they were sold by the Government of India in exchange for rupees at fixed rates. The effect of such sales was to withdraw rupees from circulation and put more gold coins into it, so that more gold coins would circulate with less rupees than before, thereby raising the exchange value of the rupee.

In short, the Government of India has endeavoured to fix the upper and lower limits of exchange by directly operating on the exchange market whenever the exchange value of the Rupee rose above or fell below specie-point.

# BOOK I

# CHAPTER I.

## Currency History before 1835.

(Two Standard coins of different metals.)

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CURRENCY BEFORE 1800 :—At the beginning of the 19th century no uniform standard coin existed in British India. In Northern India, *a silver standard* existed with gold coins in concurrent circulation, but there was *never any fixed legal ratio between them*. The Muhommaden rulers on the whole preferred silver coinage. In *Southern India*, on the contrary, where the Muhommaden conquests never extended, the *Hindu* rulers adopted *gold* as the standard.

Thus, throughout India *two standard coins* of both gold and silver were in circulation side by side *without any fixed relation* between them. The exchange value of the coins was determined by their weight and fineness.

The East India Company "found 994 different kinds of gold and silver coins current of *different weights and fineness*, and whose value was constantly varying from day to day. No one could tell the value of the coins he might hold. In making even moderate payments the parties were obliged to call in a shroff—a professional money changer—to declare the value of each coin."[1]

EARLY EFFORTS OF THE EAST INDIA COMPANY :—Finding this extremely embarrassing for revenue collection and business transactions, the East India Company attempted to issue both gold and silver coins *at a fixed legal ratio*. This estab-

[1] H. D. Macleod: Indian Currency, p. 13.

lishment of Bimetallism, however, ended in a failure as the legal ratio could not possibly be maintained while the market value of the metals was constantly fluctuating.

But with the appearance in 1806 of Lord Liverpool's treatise on the *Coins of the Realm*, the importance of the principle of Monometallism was made clear and the Governor-General in Council declared his entire adherence to it. But the choice of the Government fell on *silver* as the standard.

DESPATCH OF 1806 :—The Court of Directors of the East India Company addressed a despatch on the 25th April, 1806, to the Governments of Bengal and Madras in which they expressed themselves fully in favour of monometallism, and as regards the establishment of a standard they wrote that "they were fully satisfied with the propriety of the *silver rupee being the principal measure of value* and the money of account." But they did not desire to drive gold out of circulation, and they even proposed that a gold-rupee of the same weight and fineness as the silver coin should be coined without a ratio being fixed between the two coins.

SILVER COIN IN MADRAS PRESIDENCY, 1818 :—No action was taken on this minute until 1818, when the Government issued a new coinage of silver and gold. *They substituted the silver rupee for the gold pagoda as the standard coin of the Madras Presidency,* where gold coins had been the standard currency for thousands of years. The rupee weighed 1 tola or 180 grains. But they declared these gold and silver coins to be equally legal tender. Thus in spite of the minute of 1806 "they persevered in the *vain attempt to maintain Bimetallism.*" [1]

[1] H. D. Macleod: Indian Currency.

However, the various Presidencies under the East India Company had rupees of different weights and fineness and the rupee of one Presidency was not legal tender in another. Great inconvenience, therefore, arose in making payments, and in actual payment they were weighed as bullion. A uniform system of coinage was, therefore, found necessary.

ACT OF 1835; THE SILVER RUPEE MADE LEGAL TENDER :—Such a uniformity was obtained by the Act of 1835.

The essentials of the Act were as follows :—

(1) The Silver Rupee of the weight of 180 grains troy (150 grains pure metal and 15 of alloy or 11/12th fine) was declared to be the *standard coin and legal tender in India* and the silver coins were to be of proportionate weight.

(2) It also enacted that "*no gold coin* shall henceforward be *a legal tender* of payment in any of the territories of the East India Company".

(3) But it also authorized the coining of gold mohurs (15-rupee pieces) which were of the same weight and fineness as the rupee, and 5, 10 and 30 rupee pieces of the same standard as the gold mohur.

CONCLUSION :—*Thus silver monometallism was established in India,* and although gold had ceased to be legal tender in India as between private individuals, the provision made for coining the gold mohur meant that the authorities did not entirely discourage the use of gold by the people.

# CHAPTER II.

## Consequences of a Fall in the Price of Silver

### 1835-1893.

- **Part I, 1835-1874**
  **(Demonetization of gold.)**
  - **(A) 1835-1870**
    - (I) Demonetization of gold.
    - (II) Attempts at introduction of gold.
  - **(B) 1870-1874**
    (Gold not legal tender.)
- **Part II, 1874-1893**
  **(Falling and unstable exchange.)**
  - **(A) 1874-1878**
    (Rapid fall in price of silver.)
  - **(B) 1878-1892**
    The remedies?
  - **(C) 1892-1893**
    - (I) Herschell Committee's report.
    - (II) Closing the mints to free coinage of silver.

IMPORTANCE OF THE PERIOD 1835-1893 :—This period of the history of Indian Currency is very instructive from the economic point of view. For, in the first place, a change in the value of precious metals, silver and gold, brought with it great difficulties in maintaining the stability of the rupee; and secondly, to come out of these difficulties successfully various experiments were suggested and tried (one of which was already the favourite of a certain part of Europe then). We have, therefore, to trace the causes of the difficulties, and to see whether they were remedial or not, and then try to measure the value of the experiments made. Both these difficulties and the efforts made to overcome them, are important for study in the light of future history.

### PART I.—The period 1835-1874.

(Demonetization of gold.)

#### (A) Events between 1835-1870.

(i) Demonetization of gold.

(ii) Attempts at introduction of gold.

PROCLAMATION OF 1841. EXTENSION OF THE USE OF GOLD :—We saw in the preceding chapter that the Act of 1835 made the silver-rupee the standard coin for India. But the people continued to demand the use of gold coins and a proclamation had, therefore, to be issued on the 13th January, 1841, which authorized officers in charge of public treasuries "freely to receive gold mohurs at the rates, until further orders, respectively denoted by the denomination of the pieces." 'As the gold mohur and

the silver rupee were of identical weight and fineness, this proclamation represented a ratio of 15 : 1 between gold and silver. In this way the use of gold as currency was extended.

(i) LORD DALHOUSIE DEMONETIZED GOLD CURRENCY, 1853 :—But the extensive discoveries of gold in Australia in 1848 and 1849 caused the value of gold to fall relatively to silver. It was, therefore, held by the Directors of the Company, on representations from the Government of India, that the proclamation of 1841 had embarrassed the Government and was likely to do so still more. The reason given was that "holders of gold coin have naturally availed themselves of the opportunity of obtaining from the Government treasuries a larger price in silver than they could obtain in the market".[1] People were eagerly paying for their debt to the Government in gold, the depreciated metal, and what they gained the Government lost. Consequently a notification was issued on 25th December, 1852, by which the above provision of 1841 was withdrawn and it was declared that, on or after 1st January, 1853, "*no gold coin will be received* on account of payments due, or in any way to be made, to the Government in any public treasury within the territories of the East India Company."

By this notification gold was completely demonetized in India, and it was estimated that "£120,000,000 worth of gold coin at once disappeared from circulation and became hoarded wealth".[2]

FALL IN THE PRICE OF PRECIOUS METALS :—We have just referred to the fall in the

[1] Quoted from Fowler Committee Report, para 5.
[2] H. D. Macleod : Indian Currency.

value of gold. We shall now try to know its extent and its consequences. For many centuries the market ratio of exchange between gold and silver was 15 tolas of silver : 1 tola of gold. Any change therefore in the relative values of these metals was bound to bring about a change in the mint ratio of these metals. And this was what actually happened during that period, although not so acutely as in the succeeding one. New rich gold fields were discovered in California and Australia and in 1851 the world's production of gold began to increase. This led to a fall in the price of gold, and silver became relatively the dearer metal.

If, however, the fall in the value of gold had been heavy, relatively to silver, the intrinsic value of the Rupee would have risen appreciably and therefore its exchange value would have been raised accordingly. But fortunately this occasion did not arise because, (1) the stock of silver in the world's market began to increase as a consequence of the play of Gresham's Law in France. This country was then bimetallic and the cheaper gold coins drove out the dearer silver coins from currency. (2) Secondly, from 1865 the production of silver in the world also began to increase.

Thus, the *increase in the supply of silver tended to compensate for the increase in the supply of gold* and the latter did not depreciate much and the change in the ratio was slight.

(ii) ATTEMPT TO INTRODUCE GOLD CURRENCY INTO INDIA :—During the whole of this period we find a keen agitation by the people for the introduction of a gold currency. Efforts on the part of the Government of India were made to extend the use of gold coins. Every Finance Member favoured the

introduction of a gold currency. In 1864 the Chambers of Commerce of the three Presidencies memorialized the Government of India for a gold currency.

(I) SCHEME OF 1864 :—Sir Charles Trevelyan, the Finance Member, drew up an exhaustive scheme in favour of it in 1864, but it was not accepted by the then Secretary of State, Sir Charles Wood. It was, however, thought that an experiment might be tried to see if the people of India would be willing to use gold coins and it was declared by the Government of India in November, 1864, that

(*a*) Sovereigns and half-sovereigns minted at any authorized Royal mint in England or Australia should be accepted by the Government of India in payment by its debtors, as the equivalent of Rs. 10 and Rs. 5 respectively.

(*b*) the Government of India should, when convenient, pay the same to its creditors if they desired to receive them in payment. Even notes were also authorized to be issued under limitations in exchange for such gold coins.

(II) SCHEME OF THE MANSFIELD COMMISSION :—But such a half-hearted attempt to introduce the gold currency was not likely to encourage its use into general circulation. The agitation, however, went on and in 1866 a commission [1] was appointed to report on the best expedient to satisfy the currency demands of the increasing commerce and prosperity of the country. The recommendations of the Commission were as follows :—

(1) that gold coins [2] of 15, 10 and 5 rupees respectively would find more favour in the eyes of the people than notes of like value;

(2) that the introduction of gold would facilitate the establishment of the currency notes;

(3) and that the opinion was almost unanimous that the currency should consist of gold, silver and paper.

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[1] The President of this Commission was Sir William Mansfield.

[2] The Commission modified the units because they proved that the rupee price of the sovereign was not correctly determined by the proposal of 1864. The real par of the sovereign was somewhat above Rs. 10.

In the end they expressed a hope that, with such evidence of the general wish of the country before them, the Government of India would persevere in recommending to the Secretary of State the making of gold coin legal tender in India.

THE ATTEMPTS END IN FAILURE :—Nothing substantial resulted, however, from these recommendations and the experiment of the limited introduction of gold into circulation was carried on. In 1868 the rate for receipt of sovereigns and half-sovereigns was raised from Rs. 10 and Rs. 5 to Rs. 10-8 and Rs. 5-4 respectively (as the rate was sometimes below the average market value of the sovereign).

ACT OF 1870 :—In 1870 the Indian Coinage Act was passed which consolidated and amended all previous legislation.

### (B) 1870-1874, (Gold not legal tender).

BEGINNINGS OF A FALL IN THE VALUE OF SILVER :—Nothing eventful occurred during the first two years of this period, but the coming in of the year 1872 brought with it a distinct change in the relative values of gold and silver. What were the causes that brought about this change?

In 1871 Germany had decided to adopt the gold standard and abandon the silver standard. She now began to import large quantities of gold and as a consequence threw out silver coin from the country. Her example was followed by Denmark, Sweden, Norway and Holland. Consequently the stock of silver coins in the market increased considerably.

But this was not all. Other countries, *viz.* France, Belgium, Italy and Switzerland, that had joined together

into a *Bimetallic Union,* known as the Latin Monetary Union, began to find it difficult to keep up the fixed Bimetallic Standard, because silver began to take the place of gold in these countries. They, therefore, suspended the free coinage of silver in 1874 (and silver coin in fact became a token coin).

These two events brought with them the beginning of a fall in the price of silver.

GOLD NOT LEGAL STANDARD :—When these great changes were taking place in Europe, yet another attempt was made to obtain for India a gold currency. In 1872, Sir Richard Temple, the Finance Member, put before the Government of India a scheme for making gold coin legal tender in India. Writing in his able minute very strongly in favour of gold currency, he observed "On the whole it seems clear that while, in all other branches and departments of administration, we endeavour to give to India the best of everything so far as we can, yet, in respect to metallic currency, we deliberately withhold from her the first rate article and afford her a second-rate one."

But India was not destined to have this privilege. Sir Richard Temple resigned in April, 1874, and it was found that in the following month the Government of India decided against the recognition of gold as a legal standard of value in India. No reason whatsoever was stated for adopting a resolution which categorically ran thus : "The expediency of introducing a gold currency having been considered, the Governor-General in Council is not at present prepared to take any step for the recognition of gold as a legal standard of value in India."

## PART II.—The Period 1874-1893.

**(Falling and unstable exchange.)**

### *Section (A) 1874-1878.*

**Rapid fall in the price of silver—Its causes.**

We have just stated above the causes which brought the beginnings of a fall in the price of silver. But this fall became very rapid from 1874 and did not stop for nearly 20 years. There were many causes which combined to bring about this rapid fall. For the sake of convenience we shall divide them into two parts.

(i) *Those on the side of silver.*

(ii) *Those on the side of gold.*

(i) FACTORS AFFECTING SILVER :—Looking to the *demand* side for silver we find that if there was no great reduction in its use by Europe and America during these years at least the fact remained that these countries did not want more silver than before. It may be granted then that the demand remained nearly the same as before.

But the supply of silver increased considerably and the factors which led to this were the following :—

(*a*) As stated above most European countries adopted the gold standard and as a consequence large quantities of silver coins went to the market.

(*b*) *New* silver was being steadily produced in larger and larger quantities. Not only were new mines discovered but new inventions simplified the process[1] of producing silver. This will be seen from the following table :—

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[1] H. Stanley Jevons: *Money, Banking and Exchange in India.*

| Average annual production of silver | Ounces |
|---|---|
| 1876 to 1880 | 78,776,000 |
| 1881 to 1885 | 90,435,000 |
| 1886 to 1890 | 111,213,000 |
| 1890 | 133,237,000 |
| 1891 | 144,453,000 |

Thus in 1891 the production of silver from the mines was far greater than that in any preceding year.

(ii) FACTORS AFFECTING GOLD :—At the same time gold was appreciating in value.

(*a*) In the first place there was an increased demand for gold currency in Europe and America to meet the requirements of the increase in trade.

(*b*) In the second place the production of gold in the world declined.

CONCLUSIONS :—These, therefore, combined to bring about a fall in the general level of gold prices. And the conclusion that when all gold prices fell *the price of silver as a commodity also fell in terms of gold* is important.

### Its Consequences for India.

This rapid fall in the price of silver also affected India.

(1) The first natural consequence was *a fall in the rate of exchange*. The table shows clearly how closely related are the price of silver and the rate of exchange.

| Year | Price of Silver | Rate of Exchange | |
|---|---|---|---|
| | d. | s. | d. |
| 1871-72 | 60½ | 1 | 11⅛ |
| 1875-76 | 56¾ | 1 | 9⅝ |
| 1879-80 | 51¼ | 1 | 8 |
| 1883-84 | 50½ | 1 | 7½ |
| 1887-88 | 44⅝ | 1 | 4⅞ |
| 1890-91 | 47 11/16 | 1 | 6⅛ |
| 1891-92 | 45 | 1 | 4¾ |
| *1892-93* | *39* | *1* | *3* |

(2) Besides, the effect on the general level of prices in India was quite contrary to those in Europe and America. The cheap silver was imported into India in large quantities to liquidate her favourable balance of trade. It may be recalled that silver coin was unlimited legal tender in India at this time. And when this silver entered into circulation as money, the total currency in circulation exceeded what was actually needed and it resulted in a *rise in the general level of prices.*

| Year | Prices |
|---|---|
| 1873 | 100 |
| 1883 | 99 |
| 1884 | 107 |
| 1885 | 106 |
| 1886 | 103 |
| 1887 | 104 |
| 1888 | 111 |
| 1889 | 117 |
| 1890 | 117 |
| 1891 | 120 |
| 1892 | 134 |
| 1893 | 129 |

(3) The depreciation of the rupee brought the Government of India in great financial difficulties. The Government had yearly to remit a very large sum to England in discharge of their gold obligations known as the "Home Charges." At a rate of exchange of, say, 2*s.*, to remit every £1 to England would mean paying Rs. 10, *plus* the cost of sending it; but, at 1*s.* 3*d.* to remit £1 would mean paying nearly Rs. 16 *plus* the cost

of sending it. The great loss arising from this operation *converted a surplus Budget into a deficit Budget.* The total loss estimated was great as compared with the revenues of these years. We shall consider it when we analyse the report of the Herschell Committee (in Section C).

### *Section B.* (*The Remedies*) *1878-1892.*

The continuous fall in the gold price of silver and in the rate of exchange resulted in great uncertainties in commerce and trade. If the future of prices and the rate of exchange could not be foreseen with certainty by businessmen, it would be very difficult for them to know their profits and therefore contracts would be curtailed.

#### Proposals for a gold currency.

We therefore find that during these four years agitation was started by men and institutions connected with commerce in favour of the closing of the Indian Mints to the free coinage of silver and for the adoption of a gold standard. The economic motive behind this suggestion is very important for the student of Economics and we shall deal with it in Section C.

(a) COL. SMITH'S SCHEME :—A scheme for the adoption of a gold currency was prepared by Colonel J. T. Smith who was Master of the Mint at Madras. He suggested

(*a*) that the free coinage of silver should be suspended but that the silver rupee should continue to be legal tender;

(*b*) that gold bullion should be received by the Government at the mint rate of Rs. 38-14-0 per standard ounce, and coined into sovereigns and half-sovereigns (equal to Rs. 10 and Rs. 5 respectively) which should with rupees be declared legal tender *but not demandable;*

(*c*) that the Secretary of State should sell bills in England to such an amount from time to time that ultimately the rate would rise to 2*s*. And when this was attained gold would

flow into India for coinage, and gold coins would be made demandable and silver coins would lose their value as an instrument for payments.

THE OBJECTS OF THE SCHEME :—It was not intended that India should have a double standard ; for, as soon as the free coinage of silver was stopped, it would put a limit to its coinage, and the rupee would have a token value outside India. Whereas in Bimetallism the great requirement is that there should be unlimited free coinage of both metals.

But a change to the gold standard would be made *gradually* without causing any sudden disturbance in the prices of commodities measured in silver or gold. And as gold would be attracted to India in the course of a few years there would be sufficient gold for the introduction of a gold currency in the country.

Besides, by artificially limiting the future supply of silver coins, the rupee would be given a monopoly value ; that is, it would appreciate in terms of commodities.

(b) SCHEME OF THE GOVERNMENT OF INDIA :—Even in the year 1878, aiming at the ultimate adoption of the British standard, and the extension to India of the use of British gold coins, the Government of India represented that

(*a*) they should be given the power to receive British and British Indian gold coin in payment for any demands of the Government at rates to be fixed from time to time until the exchange had settled itself sufficiently to enable them to fix it permanently at *2s.;*

(*b*) simultaneously with this, the seigniorage on the coinage of silver would be raised to such a rate as would virtually make the cost of a rupee, to persons importing bullion, equal in amount to the value given to the rupee in comparison with the gold coins spoken of above.

The result of these suggestions would be that a "self-acting system would be obtained under which silver would

be admitted for coinage at a fixed gold rate as the wants of the country required; while a certain limited scope would be given for the introduction and use of gold coin, so far as it was found convenient or profitable.''

THE FATE OF THE PROPOSALS :—These proposals were referred by the Secretary of State to a Committee who unanimously reported *against* them. Their verdict was accepted by the Secretary of State, who in writing to the Government of India stated, ''Of one thing my Lords are sure, that it is better to sit still, than to have recourse, under the influence of panic, to crude legislation the result of which cannot be foretold, and the effect of which cannot be measured.''

**(c) Attempts at International Bimetallism.**

When such attempts failed, the Government of India tried to seek relief in an *international agreement,* which might cause a rise in the gold price of silver and thus diminish the disastrous consequences resulting from the continuance of the silver standard.

It is important to note at this stage that between 1867-1892, *four great International Monetary Conferences* were held to solve the currency difficulties of various countries of Europe and America.

THE FIRST CONFERENCE :—The *first* Conference was held at Paris in 1867, which was attended by the representatives of 18 principal countries of Europe and the United States of America. Every country at this time was aiming at securing gold for its currency in sufficient quantity and at the cheapest price possible. ''It was a scramble for gold.'' It was not, therefore, strange that at this Conference it was resolved that ''the relation between the value of gold and silver should not be established at a rate too low to permit the serious introduction of gold'',

particularly in countries having the silver standard. At the same time gold was declared to be the only standard suited to international money.

The decision of this conference gave a clear hint that it would not be possible to have a gold currency easily established in India.

THE SECOND CONFERENCE ; August, 1878 :- A few months before the second conference met in August, 1878, the United States of America made a strenuous effort in the direction of Bimetallism in the country by passing what is known as the *Bland Allison Act*. By this act silver which was dethroned as money in 1873, was to be restored as a legal tender money, and to do this the Secretary of the Treasury was required to purchase and coin each month not less than 2 million dollars and not more than 4 million worth of silver into *standard* silver dollars. The purchases were made but they were not sufficient to raise the price of silver, which continued to fall.

Hence the United States of America took the lead in convening this conference and in proposing the adoption of a common ratio between gold and silver for the purpose of establishing internationally the use of bimetallic money, and securing fixity of relative value between those two metals.

But the proposals were *not* accepted by the conference because *the interest of the gold-using countries would not allow gold to be introduced as currency by silver-using countries*. To the increasing demand for gold would be added the new demand from silver-using countries ; the price of gold would, therefore, soar high, and would embarrass the gold-using countries.

But the faith of the Government of India in Bimetallism

was not lost and in December, 1897, they expressed the opinion

(*a*) that the bimetallic standard was the best system of currency;

(*b*) that it could be obtained by an international agreement between France, Germany, United States and India;

(*c*) and that the ratio between gold and silver should be $1 : 15\frac{1}{2}$.

Thus India was to obtain "unquestionable and quite incalculable financial benefit."

THE THIRD CONFERENCE; July 1881 :— The *third* conference met in July, 1881, and this time at the instance of France and the United States of America. The proposals were the same as before, of introducing International Bimetallism. 19 countries joined the conference but England sent her delegates on the clear understanding that she was opposed to Bimetallism, and that they were sent there not to vote but to give every information the conference required. Two such delegates represented the Government of India, "but it was understood that the Government of India were not committed to the principle of bimetallic system in India."

The proposals of the French and American Governments for a double standard of value did not meet with the approval of the conference, and it failed in its object of establishing International Bimetallism.

At the same time the difficulties of the Government of India began to increase as the price of silver continued to fall, and in 1886 they wrote to the Secretary of State that the difficulties could be solved by an International agreement. But the proposal was negatived.

THE GOLD AND SILVER COMMISSION :— In 1886 a Royal Commission known as the Gold and Silver Commission was appointed in England to

enquire into the recent changes in the relative values of the precious metals, owing to the decrease in the gold price of silver. The Commission gave its report in 1888. Half the members wrote against Bimetallism on the ground that the change proposed was tremendous and that the public mind was not prepared for it. Of the other half, who wrote in favour of Bimetallism, was Sir David Barbour who represented India. But owing to this divided verdict no action was taken on the report.

THE SHERMAN ACT :—In 1890 the United States seemed to come to the help of the sliver-using countries indirectly. They passed the Sherman Act which required the Government to buy annually no less than 54 million ounces of silver. The purchases amounted to 35 to 43 per cent. of the world's production. This quantity represented nearly three times that brought under the Bland Allison Act of 1878. This artificial demand for silver undoubtedly tended to raise the price of silver and brought with it rash speculation on the part of traders and "trade between India and England became nothing short of a gamble in exchange", with all its attendant evils. But the rise in price of silver turned out to be of temporary duration, and on the contrary the *price began to fall very rapidly,* and was expected to fall to a lower level in the future.

YET ANOTHER EFFORT :—The Government of India, therefore, made yet another effort in 1892 to induce the British Government to settle the silver question by an International agreement. They made out a strong case for such a step being taken, because should an international agreement fail, the United States of America might be forced to repeal the Sherman Act and the consequences of their action would be disastrous on the price of silver.

THE FOURTH CONFERENCE; June, 1892 :—In June, 1892, the President of the United States of America invited other countries to a conference at Brussels to settle the silver question, at this time not by the weapon of Bimetallism but to settle "what measures, if any, can be taken to *increase the use of silver* in the currency system of nations". Although the purpose for which the conference was called was different from that of the preceding ones, it failed to find any definite and practical scheme upon which a large number of the delegates could agree. At the same time the representatives of the United States declared that their Government might be disinclined to continue their purchases of silver *i. e.* the Sherman Act might be repealed, and that they were determined to protect their stock of gold.

DESPATCH OF THE GOVERNMENT OF INDIA OF JUNE, 1892 :—The same month in which the Brussels conference met, the Government of India wrote a despatch in which they emphasized that, if the Brussels conference would fail, two steps should be taken :

(1) that the Indian Mints should be closed to the free coinage of silver;

(2) and that arrangements should be made for the introduction of *a gold standard*. (The details of the scheme proposed and the reasons on which they were based have been discussed by the Herschell Committee to which they were referred. We, therefore, defer their consideration to the report of this Committee.)

## *Section C.* (1892-1893.)

### The Herschell Committee's Report.

THE QUESTION BEFORE THE COMMITTEE :—The question referred to the Committee was whether, taking into account the grave difficulties with

which the Government of India were confronted through the heavy fall in gold value of silver, it would be expedient to allow the Government to carry into effect the proposals which they had made for stopping the free coinage of silver, with a view to introducing a gold standard.

THE MAIN DIVISIONS OF THE REPORT :— It would conduce to clearness if the Report is studied in the following four parts.

(i) The first part reviews the present and future situation of the Government of India as regards their revenue and expenditure and shows the extent of their financial difficulties.

(ii) The second part estimates the effect of a varying and possibly much lower exchange upon the commerce and people of India.

(iii) The third part analyses the proposals of the Government of India and examines certain objections raised to them. An appeal is also made to the policy of other nations in establishing fixity of exchange with gold-using countries.

(iv) The fourth part deals with the modifications of the proposals of the Government of India, states the recommendations of the Committee and the reasons for the conclusions arrived at.

**(I) Financial difficulties of the Government of India.**

(A) The key to the whole situation was to be found in the fact that the Government of India had to make remittances annually from India to England to the extent of nearly £17 millions sterling and the fall in the value of silver, and with it the rupee, meant that more and more rupees were required to remit every £ than previously. The following table shows clearly the extent of the loss incurred.

| Year | Amount remitted in £ | At rate of exchange | | Rupee cost of remittance |
|---|---|---|---|---|
| | | *s.* | *d.* | Rs. |
| 1892-93 | 16,532,215 | 1 | 2·985 | 26,47,84,150 |
| 1873-74 | to remit the same amount | 1 | 10·351 | 14,26,57,000 |

(B) And this additional sacrifice had converted a surplus budget into a deficit budget in spite of improvement in revenue, and as the whole revenue of India in 1892-93 was only Rs. 90 crores, the loss of that sum was really very serious in those days.

(C) Nor was this all. A further fall in the price of silver was contemplated. "A review of the changes in the price and production of silver which have characterised the last 12 years certainly forbids our entertaining any confidence that, if a further heavy fall in the price of silver were to take place, it would be, at any point capable of estimation, checked or counteracted by diminished production. It cannot be regarded, then, as otherwise than within reasonable bounds of possibility, that a repeal of the Sherman Act might lead to a fall in the price of silver of even 6*d*. per ounce, or more, and that there might be no substantial reduction from the level thus reached. Such a fall would, it may be said with practical certainty, reduce the exchange to about 1*s*. 0*d*., per rupee, and involve the necessity of raising at least Rs. 6,612,000 more than would be required by the Government of India to effect, even at the rate of exchange of 1*s*. 3*d*. per

rupee, a remittance of the amount drawn last year (1892-93)."[1]

(D) The means available for making up the deficit were either increase of taxation or curtailment of public expenditure. But were any of these possible?

(1) First, as to the possibility of increasing taxation. After reviewing the means of taxation which had been in use then, the Commission considered the new sources of taxation which were suggested to them, but they came to the conclusion that the additional revenue could be obtained "only in a manner opposed to sound principles of taxation."

(2) Next, on the possibility of reducing expenditure, they wrote, "Although, therefore, we feel strongly the necessity for the utmost care in restricting expenditure, we are certainly not in a position to conclude that any economies are possible which would enable the Indian Government to meet successfully the great and growing deficit caused by falling exchange."

**(ii) Effect of fall in exchange on the people of India and its commerce.**

The Commission tried to prove that the burden upon the people of India as a whole had *not been increased* by the fall in exchange. The arguments in support of their statement were given as follows :—

(a) EFFECT ON REMITTANCE OF PRODUCE :—"In estimating the effect upon the people of India of its being necessary to raise an increased number of rupees to meet the sterling remittances of the Government of that country, it must be borne

[1] Herschell Committee Report.

in mind that the extent of the burden imposed upon the people of India by their remittances is measured by the *quantity of produce which they represent,* for it is by the *export of produce that the debt is in reality discharged.* In so far as the necessity of exporting more produce arises from the circumstances that gold prices are lower, the people of India are in the same position as those of Australia or any other country which has to export produce for the purpose of paying the interest on its gold debt. The question to be considered is what effect has the fall in exchange upon the amount of produce which must be exported to meet a given gold liability? To determine this, the gold price of the produce must be assumed to be stationary. When silver falls in relation to gold, the greater number of rupees which is required to meet a given gold payment will *not* represent a greater quantity of produce than before, *if the silver price in India of the produce exported responds to the changed value of silver in relation* to gold, *i. e.,* if *it has risen* or has been prevented from falling. Silver prices must ultimately thus respond, although an interval may elapse before the correspondence is complete ; and during this time, whilst more produce is exported, the Indian ryot is getting proportionately less in silver for his produce.''

(b) TRANSFER OF BURDENS FROM ONE CLASS TO ANOTHER :—There was no doubt that the burden had been to some extent shifted from one class to another. (1) The burden of those who pay a fixed land revenue under a permanent settlement had been lightened. (2) But the increased salt tax would press upon the people at large, and would render the taxation heavier on those who have suffered rather than benefited

from the higher rupee price due to the fall in the gold value of silver.

(c) HARASSMENT OF TRADE BY FLUCTUATIONS :—It was indeed commonly agreed that trade was seriously harassed by fluctuations. Any sudden or violent fluctuation almost paralysed business for a time. It was however observed by the Committee that it was not so much the fall of exchange which was complained of, as the fluctuations, whether in one direction or another. Some of those who admitted the mischief to trade of exchange fluctuation alleged that the extent of the mischief was not serious, since provision could be largely made against the effect of those fluctuations through the medium of banks. But it was clear that traders could not completely safeguard themselves in this way and such security as they obtained in this respect must be paid for.

On the whole the Committee said, "it cannot be doubted that it would be well if commerce were free from the inconveniences of fluctuations which arise from a change in the relation between the standard of value in India and in countries with which her commerce is transacted."

(d) ALLEGED STIMULATION OF EXPORTS :—It was said that the tendency of a falling exchange was to stimulate exports; that, inasmuch as more silver, *i. e.*, a higher silver price was received in respect of the same gold price, whilst wages and other factors in the cost of production did not increase in the same proportion, production became very profitable, and was, therefore, stimulated.

"Assuming this to be true", said the Committee, "the effect of each successive fall must be transitory, as can continue only until circumstances have brought about the

necessary adjustment." Even assuming the proposition that a falling exchange stimulated export was true, the examination of the statistics of exported produce did not afford any substantial support to it. On the contrary, statistics proved that export trade had been less with a rapidly falling than with a steady exchange. For example, from 1871-72 to 1876-77, the gold value of the rupee fell $11\frac{1}{4}$ per cent., but exports were actually less in the latter year than in the former, and imports increased by 17 per cent.

(e) CHECK TO INVESTMENTS IN INDIA :—It was alleged that "the want of a stable exchange between England and India, and the fact that it has fallen so heavily, has greatly checked the investment of British Capital in India and the consequent development of the country."

But the Committee wrote, "Indeed, uncertainty as to the interest which would be received for the investment, and as to the diminution which the invested capital might suffer if it were desired to retransfer it to this country, tends to check British investments in India. This is a real evil. But this check is due to other causes which are more substantial. Capitalists have been slow to invest in many kinds of industrial enterprise, owing to the fact that prices are falling, or have fallen, very generally. Besides, London is the lending market and London thinks in gold. London is ready enough to lend upon contracts for repayment in gold, but hesitates to enter upon silver transactions, or to engage in industrial enterprises in a silver country."

(f) INDIA MADE TO BUY DEPRECIATING SILVER :—It was said that, by making silver the standard, and keeping the Indian mints open to silver, "the

Anglo-Indian Government have attracted to India that depreciating metal, and have thus made India purchase, at a comparatively higher cost, an enormous quantity of it, which is now of less value than when it was brought."

To this the Committee answered, "In this there is some truth, but also much exaggeration. It is only when and so far as the opening the mints to silver has led to the importation and coinage or hoarding of useless and now depreciating silver, that the free coinage of silver can be considered to have inflicted a loss upon India. What this loss amounts to cannot be determined, but we are not without indications that India is becoming *surfeited with silver*."

**(iii) Proposals of the Government of India considered.**

DESPATCH OF 21ST JUNE, 1892 :—In a despatch of 21st June, 1892, the Government of India expressed their deliberate opinion that, if it became clear that the Brussels conference was unlikely to arrive at a satisfactory conclusion, and if a direct agreement between India and the United States were found to be unattainable, they would at once close the mints to the free coinage of silver and make arrangements for the introduction of *a gold standard* into India.

SIR DAVID BARBOUR'S PLAN FOR A GOLD STANDARD :—Together with these proposals was also despatched a minute by Sir David Barbour, the Finance Member of Council, giving an outline of the method he proposed for the introduction of a gold standard into India. The nature of the plan was as follows :—

(1) The first measure would be the stoppage of the free coinage of silver. Government would retain the right of purchasing silver and coining it into rupees.

(2) The next measure would be to open the mints to the free coinage of gold. A man bringing gold to the mints would

be entitled to have it coined into gold coins, which would be legal tender to any amount. It would be desirable to stop the free coinage of silver before opening the mints to the free coinage of gold. "It would be a reliable guide to us in subsequent proceedings to know exactly what effect the stoppage of the free coinage of silver had on the gold value of the Rupee."

(3) The new gold coins to be a 10-rupee piece and a 20-rupee piece.

(4) The weight and fineness of gold coins would be such that the par of exchange between them and the Sovereign would be the exchange which it was desired to establish between England and India.

For example, if the Rupee was to be worth 1*s.* 4*d.*, the 10-rupee coin would contain as much gold as was worth (1*s.* 4*d.*) × 10 = 160 pence. The quantity of fine gold in the 10-rupee piece would be 160/240ths or two-thirds of the quantity contained in the sovereign.

(5) The proposals as to the fixation of the ratio of exchange from the silver to the gold standard were as follows:—

(a) "We ought not to think of going back to the old ratio of 1 : 15½. Neither ought we to adopt the very lowest price to which silver may have fallen at any time."

(b) "A ratio based on the average price of silver during a limited period before the introduction of the gold standard would probably be both the safest and most equitable."

HIS ARGUMENTS :—He gave the following reasons in support of his scheme, which are of interest to a student of Economics. He observed : (1) Although it was proposed to stop the free coinage of silver and to establish a gold standard, *it was no part of the plan to substitute gold for silver as the ordinary currency of the country.* It was contemplated that, in the vast majority of Indian transactions, *silver would still be used* as a medium of exchange. He referred to the example of France and other nations as showing that it was possible to have a gold standard, though a large percentage of the circulation consisted of overvalued silver coins, which were legal tender to any amount. (2) In order that the gold standard

might be effective, *a limit must be placed* on the number of such coins, and they must be convertible into gold coins with or without the paying of a trifling premium. Gold coins would only be required in exchange for silver when they were wanted for hoarding or export or for melting down into ornaments. (3) There was the possibility of no gold being brought to the mints to be coined and put into circulation or brought for a time and then discontinued. This would diminish the amount of gold coins required for circulation and enhance the value of gold coin and bring down the exchange value of the rupee, *i. e.,* rate would fall. This would mean that the rupee was redundant, or, in other words, that there were too many silver coins in circulation, and that the gold standard was not effectively maintained. The remedy in such a case would be to contract the rupee currency, and to adopt any feasible measures to improve the general financial position of the country. This then would be an effective weapon to control the rate of exchange.

TELEGRAM OF 22ND JANUARY, 1893 :—In a telegram of the 22nd January, 1893, the Government made the following further statement regarding their proposals :—

(1) that English Gold coinage shall be legal tender in India, at a rate of not less than $13\frac{1}{3}$ *rupees for one Sovereign* i. e. *the rate of 1s. 6d. per rupee ;*
(2) that power to admit sovereigns as legal tender might be of use as *ad-interim* measure and *will not* be used except in case of necessity.

**The Commission's consideration of these proposals.**

But the Committee decided (1) *against* the suggestion for introducing gold currency and (2) *against* the fixation

of a higher ratio, i. e. 1s. 6*d*. per rupee as recommended by the Government of India.

**(A) That Gold Currency was unnecessary and undesirable.**

As regards the introduction of gold currency, they wrote that it was both *unnecessary* and *inadvisable*. In support of their statement they gave a survey of the different currency systems of various countries.

(1) METHODS ADOPTED BY OTHER COUNTRIES :—The lesson drawn from a study of these systems was that many countries had adopted the gold standard, and a substantial parity of exchange with gold-using countries was maintained by them without *actually using gold or using very little of it in circulation.* The methods adopted to maintain the parity of exchange were under the following conditions :—

(a) With little or no gold, as in Scandinavia, Holland and Canada.

(b) Without a mint, or gold coinage, as in Canada and the Dutch East India.

(c) With a circulation consisting partly of gold, partly of overvalued and inconvertible silver, which was legal tender to an unlimited amount, as in France and other countries of the Latin Union, in the United States, and also in Germany, though there, the proportion of overvalued silver was more limited, the mints in all these countries being fully open to gold, but not to silver, and in some of them the silver coinage having ceased.

(d) With a system under which the banks part with gold freely for export, as in Holland, or refuse it for export, as in France.

(e) With mints closed against private coinage of both silver and gold, and with a currency of inconvertible paper, as had been temporarily the case in Austria.

(f) With a circulation based on gold, but consisting of token silver, which, however, was legal tender to an unlimited extent, as in the West Indies.

THE LESSON FOR INDIA :—The general conclusion drawn by the Committee was "that it had been

found possible to introduce a gold standard *without a gold circulation*; without a large stock of gold currency; and even without legal convertibility of an existing silver currency into gold."

It was admitted by the Committee that what was true of other countries could not necessarily be true of India. Even in the case of Holland and its East Indian Colonies, which was *prima facie* very much in point, "there are differences which detract from its value as a precedent for India." The circumstances of each particular country must be studied; yet, they stated, "the experience derived from the currencies of other countries is not without value as bearing on the questions we have to consider."

Nicholson[1] truly regretted that the Committee did not emphasize the fact that in every one of these cases the same general principle was exemplified the principle of *limitation,* first definitely established by Ricardo.—"Any kind of currency can be maintained at an artificial value, provided only that it is strictly limited."

(2) ITS PROBABLE EFFECT ON SILVER COINED AND UNCOINED :—They also found the introduction of gold currency *inadvisable* because it would have an adverse effect on the gold value of (a) uncoined silver and of (b) coined rupees.

**(a) Its effect on the gold value of uncoined silver.**

INDIA'S DEMAND FOR SILVER :—Judging from the following figures it would be seen that India absorbed nearly the whole of silver imported into it.

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[1] Nicholson: *Money and Monetary Problems.*

**1875-76 to 1892-93: (yearly average)**

| Total demand of India for currency | Net imports of silver |
|---|---|
| | Rs. |
| Rs. 77,00,000 (and more) ... ... | 83,28,344 |

Besides, the currency demands of India had during those years been nearly $\frac{1}{4}$, and those of the United States more than $\frac{1}{3}$, of the whole world's production.

If, therefore, either the one or the other were to cease, there ought, according to general laws, to be a great fall in the value of silver, and if both were to cease the fall would be precipitous.

(1) POSSIBLE PANIC IN SILVER MARKET :- The closing of the Indian Mints would, no doubt, make it more likely that the United States would give up buying silver, and, if the apprehension of this were added to the cessation of the Indian demand, the effect might be a panic in the silver market. Ultimately, however, the price of silver would settle down to the new circumstances of demand and supply.

(2) POSSIBLE RISE IN VALUE OF GOLD :—If the effect of the proposal of the Indian Government were, sooner or later, to cause a demand for gold in India, which did not exist then, it might raise the value of gold as against all other things, including silver, *i. e.* the gold price of silver might be still further diminished.

**(b) Its effect on the value of coined silver.**

Next, as to the effect of simply closing the mints, on the future value of gold price of the rupee. If there were

already, as there was reason to suppose, a quantity of unused rupees in India, they would have to be absorbed before the closing of the mints produced an effect on the value of the rupee. In that case, there might be some time to wait before there was any increase in its value. The apprehensions of men concerning the future might cause an immediate effect of a serious character, but they stated "we cannot venture to say for what length of time this would be maintained. Neither could we trace the progress of the enhancement of the value of the rupee, in respect of time or place, which we should expect to follow the closing of the mints."

**(B) That 1s. 6d. ratio would be injurious to India.**

Consideration was next given to the effects of raising the ratio to 1*s*. 6*d*. as proposed by the Government. In order to make these effects clear they considered the probable results of closing the mints to the free coinage of silver *without* the ratio being raised to 1*s*. 6*d*.

(a) *Supposing the ratio were not to be raised, and silver were to fall owing to the closure of the mints*:—

(1) It was represented by some that a serious amount of spurious coinage would result. There was the danger of the illegal coinage of silver in India, in the native states or in foreign countries; for if such were put into circulation, it would be an extremely profitable enterprise.

But the Committee expressed their opinion that it was difficult to estimate precisely the real extent of the alleged danger, and that, as expensive and specially constructed machinery would be requisite to carry out such operations on an extended scale, they doubted whether the danger of India being flooded with large amount of spurious coins would really be a grave one.

(2) Next, the effect of closing the mints (on the assumption taken above) on the *hoards of silver* coined and uncoined in India itself was considered.

Coined rupees, of which the hoards chiefly consisted, would, they wrote, be unaffected, except in so far as any further fall in their gold value would be prevented; but *the uncoined silver and silver ornaments* would cease to be convertible into rupees, and would certainly be *depreciated in value.*

(3) Another objection raised was that the proposal would, if there should, in future, be a divergence between the value of the rupee and the market price of silver, have the effect of converting the whole of the currency of India into a *token currency* which would not differ in principle from an inconvertible paper currency.

But the Committee stated that one of the greatest risks connected with an inconvertible paper currency, *i. e.* the temptation which it afforded to the Government of expanding unduly the amount in circulation, did not exist in the proposals of the Indian Government.

(4) It was also objected that placing power in the hands of the Government of expanding or contracting the currency at will, would *not make* the currency *automatic.*

But the Committee stated the assumption was that the exchange *was not to be practically raised above the level which then existed.* If, however, the rise in exchange were checked by the reception of gold, as suggested by the Government of India, the discretionary power vested in that Government would be confined within narrow limits, because if the rupee were to rise above the fixed ratio to such an extent as to cover the expenses of transmission and of coinage, it would become profitable to take gold to the Indian mint, or to send sovereigns to

India, and thus the currency *would be made automatic on a gold basis.*

(5) Another serious objection urged was that, if the proposal of the Government were carried out, and there should arise a great *divergence* between the ratio borne to gold by the rupee and by silver respectively, it would *seriously affect the trade of India with silver-using countries,* and stimulate in those countries the production of commodities which compete with Indian commodities in the markets of the world and seriously affect India.

This argument will be discussed in parts :

(i) First as to the effects on the exports of India to silver-using countries : The most important country in this category was China which took from India a large quantity of manufactured commodities. It was contended that, if the divergence between silver and the rupee became considerable, the same silver price would mean a *lower rupee price,* i. e. more rupees would be necessary to buy the same units of commodities as before, quoted in silver price. Besides, the cost in rupees to the Indian manufacturer of cloth would be greater as compared to that in China. Suppose, for instance, in India 100 units of cloth were equal to 100 units of silver. Under the new conditions, to produce these 100 units the cost in rupees would be greater. This would mean a great loss to the Indian manufacturer, who could not so quickly diminish his rupee cost of production. Thus, trade would be less profitable and its volume would be diminished.

But the Committee stated that the Indian produce imported into China *was paid for ultimately by goods* exported by China to other countries, and that, *if the gold price of these commodities did not fall* owing to a fall in the gold value of silver, they would realize *a higher silver*

*price*, and that China would thus be able to pay a higher price for the Indian imports.

(ii) It was further suggested that, if the fall of silver should continue to be considerable, it would afford a great inducement to *promote the manufacture* in China of cotton goods in place of those imported from India.

But the Committee stated that China was slow to move owing to impediments and burdens which were imposed upon that country's industrial enterprise.

(iii) It was further argued that, if a great divergence between silver and the rupee took place, India would *lose her trade* in competition with silver-using countries *in other markets*. Thus, if there was a great divergence between the value of silver and of the rupee, a considerably lower gold price would, in China, represent the same amount of silver as before, whilst to India it would give fewer rupees. The Chinese would be content with charging the same silver price as before, but the Indian producer must be satisfied with a lower rupee price, or perhaps be driven out of the market altogether through the stress of competition.

The Committee granted that in this case the Indian producer would suffer a great loss until *wages and other elements of cost of production had adjusted themselves to the new level of prices*, and that *the interval must be considerable* before such adjustment could be effected, for India's industrial institutions were but little developed. But they concluded that "consideration of the experience derived from the study of the history of Indian exports during the period characterized by a fall in the gold value of silver, leads us to doubt whether the suggested advantage is not so much less than those who urge the argument suppose."

(*b*) *Supposing the ratio were to be raised materially above the present level:*

The suggestion of the Government of India was that no ratio should be fixed immediately on the closing of the mints. Their proposal to own power to declare that English gold coinage shall be legal tender in India, at a rate of *not less than* $13\frac{1}{3}$ rupees to the sovereign, would, if acted upon, prevent the exchange from rising to any great extent above 1*s.* 6*d.*

But the Committee stated that all the objections which were considered in (a) were at least equally applicable in this case, but the answers were not equally forcible.

The dangers of spurious coinage and of depreciation of Indian hoards *must increase* in proportion to the difference between the value of the rupee and the market value of silver.

Besides, trade difficulties due to a rising exchange, such as they were then, would, of course, be the greater the higher the ratio were taken.

Moreover, the difficulty of maintaining the inconvertible token coinage as full legal tender at a par value would tend to increase with the difference between the legal value of the token coin and the metal it contained; but the cases of foreign currencies quoted above showed that difficulties similar to those which were apprehended in the case of India had been successfully encountered.

**(iv) Possible modifications of the proposals of the Government of India and Recommendations of the Committee.**

If, then, there were admitted objections to the proposal of raising the exchange value of the rupee to 1*s.* 6*d.*, what was to be the fate of the proposals as a whole? They were undoubtedly to be modified. But any modified scheme should be such as to remove the various risks

and inconveniences that were likely to arise by the change.

THE POSSIBLE DANGERS TO BE AVOIDED :—(1) In the first place, the cessation of free coinage would, in all probability, be immediately followed by *a fall in the price of that metal.* If at the same time the exchange had risen considerably, the divergence between the rupee and its intrinsic value would become at once marked, and the *difficulty of maintaining the rupee* at its higher exchange value might be increased and the apprehensions of disaster would be intensified.

(2) Moreover, the rise in exchange would be calculated *to lead to a fall in the price of Indian produce.* And, if this were seen to follow, and believed to be caused by the action of the Government, public opinion might be disturbed and the situation might become critical.

These, then, were the dangers to be avoided and the scheme was to afford *security against any sudden and considerable rise of exchange.*

THE REMEDY AND ITS BENEFITS :—But what was to be the remedy adopted? It was to be provided that the mints should be closed to the public for the coinage of silver, but should be used by the Government for the coinage of rupees if required by the public in exchange for gold, at a ratio to be fixed in the first instance *not much above the one prevailing, say 1s. 4d.* to the rupee.

Such a measure would bring the following effects :

Any fear of considerable rise would thus be allayed, and any evil effects of such a rise would be prevented.

Moreover, even if silver fell, the divergence between the nominal and the intrinsic value of the rupee would not be so great as if exchange at the same time rose.

Besides, there would be these additional advantages.

(a) The currency would *not cease* to be automatic.

(b) It would be a less violent step than the closing of the mints altogether. They would practically remain open subject to certain conditions. It would be the smallest departure from the *status quo* that could accomplish the object.

(c) Moreover, it would still leave the volume of rupee coinage dependent on the wants of the people of India, and the fact that rupees might continue to be coined would tend to prevent silver falling as much as would be the case, if it were supposed that the coinage of rupees was to cease altogether.

#### The Recommendations of the Committee.

The Committee, *on these grounds*, therefore, made the following recommendations : (1) that the closing of the mints to the free coinage of silver should be accompanied by an announcement that though closed to the public, they would be used by the Government for the coinage of rupees in *exchange for* gold at a ratio to be then fixed, say 1*s*. 4*d*. *per rupee*; (2) and that at the Government treasuries *gold would be received* in satisfaction of public dues at the same ratio.

CONCLUSIONS :—The following results ensued from these recommendations :—

(*a*) The mints were to be closed to the free coinage of both *silver and gold*, because by the Act of 1870 both silver and gold were received at the mints and coined, although gold coins were not declared legal tender.

(*b*) The rupee was made a *token coin*, since its ex-

change value was kept greater than its intrinsic value and a limit was put to its coinage.

(c) Besides, no specific provision was made for the introduction of a gold standard, although it was contemplated to establish a gold standard in the future. They expressed the opinion that a *transition period was necessary* in which the rate of exchange would be brought up to 1*s*. 4*d*. When this was achieved a gold standard would be established. That no provision was made for the future establishment of the gold standard was emphasized by Lord Farrer and Lord Welby, who wrote in a supplementary note, "A reserve (of gold) should, we contend, be provided before the Indian Government takes the final step of announcing gold as the standard, coupled with the correlative obligation to give gold for silver."

# CHAPTER III.

## History during the years 1893-1900.

**1893-1900.**

| Section I. | Section II. | Section III. | Section IV. |
|---|---|---|---|
| Act of 1893. | 1893-1895. | 1895-1899. | Report of Fowler Committee and Gold Currency for India. |
| Closing the Mints to gold and silver. | Continued fall of silver. (The causes.) | Raising the rate to 1s. 4d. by Contraction of Currency. | |

## SECTION I—Closing the Mints to the Free Coinage of Silver and Gold.

THE COINAGE ACT OF 1893 :—The recommendations of the Herschell Committee were accepted and Act VIII of 1893 was passed on 26th June of the same year by which the *mints were closed to the free coinage of both gold and silver,* Government retaining the right to coin silver rupees on its own account. Three notifications were also issued at the same time by which (1) gold coins and gold bullion were to be *received at the Mints* in exchange for rupees at the rate of 7.53344 grains troy of fine gold for one rupee, (*i. e.*, 1*s.* 4*d.* per rupee); (2) sovereigns and half-sovereigns were to be *received* in payment of sums due to Government as the equivalents of Rs. 15 and Rs. 7-8 as. respectively ; (3) currency notes were to be issued in exchange for gold coin or bullion at the same rate.

ITS INHERENT DEFECTS :—This legislation manifestly presented certain defects which may be called inherent. Whilst the Government of India was obliged to

*receive gold* coins and gold bullion in exchange for rupees, it had *no obligation to give gold* in exchange for rupees. The obligation on the Government to coin silver rupees when the exchange was at 1*s.* 4*d.*, did not itself carry with it a corresponding obligation on the part of the Government to give gold for the rupees. This was its imperfection. Sir David Barbour himself held that, eventually, if the scheme were to be successful, *gold when required must be given for the rupee,* either with a premium or at a small premium. "It is of course obvious that a great country like India, if she undertakes a token currency, is under an obligation to maintain its value, and that she ought to discharge that obligation by making it reasonably certain that, where gold is needed in exchange for rupees, it will be possible to obtain it at a fixed ratio[1]". In short, without this corresponding obligation to give gold for the rupees, it was questionable whether this gigantic token currency would be kept at par value for all times.

Suppose during a particular year the balance of trade became *unfavourable* to India owing to circumstances, such as a failure of monsoon. The exchange would, therefore, tend to fall. An unfavourable trade balance suggests that *more money is to be paid to foreign* countries than is to be received from them. In this case, therefore, the best method of keeping exchange at parity is to *give gold to Indian debtors* in exchange for rupees, to be exported to foreign countries. The result would be automatic ; rupees would be reduced in quantity in circulation and the amount of gold in circulation would increase, *i. e. less rupees would exchange with more gold than before in circulation,* the exchange value of the rupee

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[1] Lord Farrer and Lord Welby wrote in a supplementary note to the Report.

would thus tend to be kept up to the original level. Besides, this would be a natural course for correcting the exchanges.

But in the system such a natural course was not provided for. The absence of gold to be made available for debtors was the great weakness of this system.

## SECTION II—Continued Fall of Silver during 1893-95.

The object aimed at by the closure of the mints was to give the rupee an artificially high value by making its supply scarcer relative to the demand for it.

But in the beginning circumstances were against such an artificial scarcity being created.

CAUSES OF FALL OF SILVER:—In the first place, there was already a great volume of rupees in circulation and the increasing imports of silver into India, led, during the year 1893, to large issue of rupees from the Mints and the total amount of rupees was sufficient to meet the requirements of the next few years.[1]

Besides, on November 1st, 1893, America suspended the silver purchase clause of the Sherman Act, and, as the artificial demand for silver was cut off, the price of silver fell in consequence, and "no less than 37 per cent. of the world's annual production was dumped on the market."

Then, during the months July 1893 to February 1894, in order to liquidate the favourable balance of trade, *heavy imports of silver* came into India.

The rate fixed by the Act for the sale of Council Bills was 1*s*. 4*d*. per rupee. But at this time the Secretary of State sold the Bills at the market rate which was *much*

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[1] Findlay Shirras: *Indian Finance and Banking, page 144.*

*below* 1*s.* 4*d.* This led the people to believe that the Government could not raise the rate of exchange and caused great inconvenience. It was, therefore, decided by the Secretary of State that, to allay fears, the Bills would be sold at the minimum rate of 1*s.* $3\frac{1}{4}$*d.* per rupee, which was higher than the market rate then existing. The debtors in England would not, therefore, buy the Bills and preferred as an alternative to remit silver to India. This, then, led to a considerable import of silver.

All these causes combined together to bring about a fall in the rate of exchange. The following figures show the extent of the fall of silver and of exchange.

| Year | Intrinsic value of rupee as silver bullion | | Average exchange value of rupees | |
|---|---|---|---|---|
| | *s.* | *d.* | *s.* | *d.* |
| 1892 | 1 | $3\frac{1}{4}$ | 1 | $3\frac{1}{4}$ |
| 1893 | 1 | $1\frac{5}{8}$ | 1 | $3\frac{1}{8}$ |
| 1894 | 0 | $11\frac{1}{8}$ | 1 | $1\frac{1}{2}$ |
| 1895 | 0 | $11\frac{3}{8}$ | 1 | $1\frac{3}{8}$ |
| 1896 | 0 | $11\frac{7}{8}$ | 1 | $2\frac{1}{2}$ |
| 1897 | 0 | $10\frac{1}{2}$ | 1 | $3\frac{1}{4}$ |
| 1898 | 0 | $10\frac{3}{8}$ | 1 | $3\frac{7}{8}$ |
| *1899* | *0* | $10\frac{7}{8}$ | *1* | 4 |

(Taken from Jevons: *Money, Banking and Exchange in India.*)

## SECTION III—Contraction of Currency and raising Exchange to 1s. 4d.

WHY EXCHANGE CONTINUED TO FALL[1]? :- We now reach the period during which the rate of exchange was steadily raised until it reached 1*s.* 4*d.*, the

prescribed limit, but as the figures in the above table show, it was not till 1899, that this was done. The relative scarcity of the supply of rupees, as compared to the demand for them, could not be clearly felt until 1899 and this was due to various circumstances.

The years 1896 to 1898 were bad years for India. The country was in the grip of famine and plague, and her production of food-stuffs and materials was reduced and with it their exports to foreign countries.

At the same time, the foreign demand for Indian products fell, as most European countries were experiencing a severe depression of trade. India could not, therefore, enjoy her usual favourable balance of trade.

CONTRACTION OF CURRENCY :—But with the recovery in trade the exchange was raised to 1*s*. 4*d*. by the contraction of currency. That the volume of currency was contracted during this period is proved from the following facts :—

(1) In the first place, there was a decided *increase in the volume of business,* at the same time the *active rupee circulation actually decreased.*[1]

(2) Whether contraction of currency took place or not could also be evinced from the *discount rates* charged by banks to their customers. If the rate charged by banks for demand loans rises, it indicates that demand for money is greater than its supply, *i. e.,* stringency exists in the money market. Since the average discount rates

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1 Mr. Findlay Shirras in his *Indian Finance and Banking* (pages 161-167) proves this conclusively. He shows that in 1900 (as compared with 1893), (1) at the same time that the volume of business increased 39 per cent. the volume of active circulation decreased by nearly 4 per cent. and (2) even if the total circulation of rupees, notes and cheques is considered, it shows an increase of about 21 per cent. as against the increase in business of 39 per cent.

of the Presidency Banks during 1898, rose to 8 per cent. as against 4 per cent. in 1893, it indicated that contraction of currency must have taken place.

(3) If the general level of prices fell, it would show that contraction of currency must have taken place, *i. e.* if *less* rupees exchange with the *same* number of commodities or more commodities than before, the purchasing power of the rupee would be raised, or there would be a fall in the general level of prices. The statistics of prices during this period indicate that contraction of currency must have taken place.

| Year | Index Number |
|---|---|
| Average of 1868-76. | 100 |
| 1893 | 125 |
| 1894 | 119 |
| 1895 | 116 |
| 1896 | 127 |
| 1897 | 149 |
| 1898 | 122 |
| 1899 | 117 |

(Taken from Wadia and Joshi: *Money and the Money Market in India.*)

Had the monsoon not failed in 1896, the fall in prices would have been continuous.

THE GOLD NOTE ACT, 1898 :—In 1898 an Act was passed to give elasticity to the currency. It authorized

the issue, at the same rate, of *notes in India against gold deposited in London* with the Secretary of State and earmarked at the Bank of England as part of the Paper Currency Reserve.

### SECTION IV—Report of the Fowler Committee.

GOVERNMENT OF INDIA'S DESPATCH OF MARCH, 1898 :—We have seen above that the Government of India had to wait for five years before the exchange could be raised to 1*s.* 4*d.*, and when in the beginning of 1898 the rate seemed to reach the stipulated limit, they thought that it was desirable in *the interests of the State and of mercantile community,* which had suffered so long from evils of an unstable exchange, to *terminate the period of transition* without further delay. They, therefore, sent a despatch in March, 1898, to the Secretary of State, details of which we shall presently consider. The Secretary of State appointed in April, 1898, a Committee presided over by *Sir Henry Fowler* to consider the proposals of the Government of India, and various schemes put forward by individuals, and to make their own recommendations for the establishment of a satisfactory system of currency in India. In July, 1898, the Committee gave its report. A study of their report will be made into convenient parts.

### PART I—Consideration of the Indian Government's Proposals.

PROPOSALS OF THE GOVERNMENT OF INDIA :—In their despatch of March, 1898, the Government of India emphasized the importance of *terminating the period of transition* without delay. But in order to achieve this purpose, they proposed as follows :—

(*a*) The first step proposed was to take powers to *borrow* sums not exceeding £2 crores in England and to remit to India ¼ of this amount in sovereigns to form the first instalment of a *gold* reserve to be established for the future establishment of the gold standard.

(*b*) Then nearly Rs. *2.40 crores,* the estimated redundant amount, were to be withdrawn from circulation and were to be *melted down* to raise the gold value of the rupee.

(*c*) And the silver bullion obtained by melting down these rupees was to be sold off for *gold* which would be an addition to the gold reserve.

These measures, in short, were suggested to keep the exchange value of the rupee at a steady level of 16*d.* Thus, if the exchange fell below 16*d.*, the Government of India would adopt the following procedure :—First take rupees from its *balances,* melt them down, sell the bullion for *other rupees* in India, pay these other rupees into its balances, and the loss incurred by this process would be made good with the part of the borrowed gold.

As a result, it was anticipated that by the automatic operations of trade, gold would flow into India and remain in circulation. But they wrote, "until the exchange value of the rupee was established at 16*d.* and sovereigns became, to some extent however small, a permanent part of the circulation, it was not the Government's intention to part with any of the gold in their possession. Meantime, *gold was not to be made legal tender in India,* though the Government looked forward to this as a future goal."

THE COMMITTEE REJECTED THE PROPOSALS :—The proposals were based on the belief that the rise in the exchange value of the rupee, subsequent to the year 1894-95, was due to a contraction of the currency relative to the demands of trade, and that the cause would continue to operate so long as the Indian Mints were closed to silver.

The Committee pronounced its opinion *against* this belief. They stated, "it is not certain that there has been any contraction of Indian Currency which has naturally affected the exchange, though it may not unreasonably be inferred that there must have been some contraction, and that such contraction had some influence on the exchange value of the rupee. On the other hand, there are causes other than contraction of currency."

They pointed out that since the mints were closed, there had been large borrowings on Indian account, and there had been in some years large reductions below the normal amount in the public remittances from India, while fluctuations had been experienced in the foreign trade of India, on account of various causes. All these causes, they said, must have at different times affected the exchange either favourably or unfavourably. Besides, the reduction in the imports of silver due to the closing of the mints must have had a favourable effect on the Indian exchange.

In the face of these facts, therefore, the Committee refused to accept that the rise in exchange was due mainly or wholly to the contraction of currency, and that it was not safe to base action of so drastic a character on the assumption.

Besides, they stated: "though we accept in principle the proposition that a reduction in the number of rupees tends to increase the value of the rupees, we are not prepared to admit that such effect must necessarily be direct and immediate, nor are we satisfied that such reduction, carried out on a large scale and within a limited period, might not aggravate, if it did not produce, a *period of stringency* in the Indian money market." That such a stringency would be created was also emphasized by the

commercial classes of India. Therefore, the proposals would not inspire confidence into them.

In their proposals the Government of India showed great anxiety to terminate the period of transition without further delay. They described this transition stage as the stage of distrust, which would be passed the moment exchange reached 16*d.* per rupee.

But, since they wrote in March, 1898, there had been a marked improvement in the position. The exchange was steady at or about 1*s.* 4*d.*, the drawings of the Secretary of State had been unusually large, and a substantial sum of over £2,370,000 in gold had been brought to the Indian Treasury, *i. e.* the stage of distrust, which had interfered with the actual realization of a rate of 16*d.*, had been already passed.

On these grounds, therefore, the proposals were rejected by the Committee.

### PART II—Should the Mints be reopened to Silver?

Various persons had represented to the Government of India that the Indian Mints should be reopened to the unrestricted coinage of silver either immediately or gradually, *i. e.* India should have Silver Monometallism. The Government of India, on their part, pronounced their opinion *against it,* but asked the Committee to consider the question.

THE ARGUMENTS SUGGESTED IN FAVOUR OF REOPENING MINTS :—The chief arguments in favour of reopening the mints brought forward by its supporters were :—

(a) that the system of closed mints handicapped India in her industrial competition with countries on a silver standard;

(b) that "a low Rupee and a low exchange" would encourage the export trade on which India's prosperity depended and that an "arbitrarily enhanced" Rupee discouraged exports.

THE COMMITTEE REFUTED THEM :—This aspect of the question was considered by Lord Herschell's Committee which had expressed its opinion that "even if we assume the argument as to a stimulus or check to production to be sound, the effect of each successive fall in exchange must be transitory and could only continue until circumstances have brought about the inevitable adjustment."

In this opinion, the Fowler Committee concurred. The Herschell Committee had examined the statistics of Indian exports for a series of years, and had concluded that, far from the export trade having been encouraged by a falling exchange, its progress had been less with a rapidly falling than with a steady exchange. The Fowler Committee, too, were unable to find any statistical support for the theory that exports are largely and permanently stimulated by a depreciation of the standard of value, resulting in a fall in exchange, and they concluded that the statistics of the Indian export trade since 1893 were no good guide in deciding this question, for their value for this purpose was much diminished by the *special disturbing influences* to which that trade had been subjected since that date.

Besides, the Committee recognized that fluctuation of exchange constituted an obstacle to international trade, and wrote, "since over *four-fifths of India's seaborne foreign trade is with gold-standard* countries, it follows that the balance of advantage is heavily in favour of stability of exchange with gold standard countries ; and

accordingly, considered by itself, the instability of exchange which must be anticipated from reopening the Indian Mints to silver, is a powerful argument against taking the step''. They emphasized that it was not in the permanent interests of India, that her foreign commerce, over 80 per cent. of which was with gold standard countries, should be hampered by the restoration of silver monometallism.

In view of these considerations, the Committee concurred with the Government of India in their decision not to revert to the silver standard.

### PART III—The Principle of a Gold Standard.

The practical alternative to silver monometallism was a gold standard, *i. e.,* gold as the measure of value in India, either with a gold currency or with a gold reserve, and the Committee laid down certain advantages which India was to derive by adopting gold as the measure of value.

ADVANTAGES TO INDIA OF A GOLD STANDARD :—(a) In the first place, they referred to the fact that over four-fifths of the foreign trade of India was with gold standard countries, and that for the same reason it was desirable that India should have the same measure of value as those countries. Regard being had to the supremacy of gold in international commerce, the change to a gold basis would facilitate interchange of commodities. This advantage was represented before the Committee by Professor Marshall as ''like a movement towards bringing the railway gauge on the side branches of the world's railways into unison with the main lines''.

(b) A further and certainly not a less important con-

sideration pointed out for a country like India was that an established gold standard was the simplest and most effective means of *attracting capital.* The need for foreign capital was indisputable, and this need was partly of a temporary and partly of a permanent character. For climatic reasons, India has been essentially a country of seasonal trade ; she has had a busy season and a dull season. From this seasonal character, it followed that the demand for money has been much greater for one part of the year than for another. In the busy season, there has been a brisk demand for money for temporary advances to move crops ; in the dull season money has been in little demand. This led to great seasonal variations in discount rates and to great *stringency* during the busy season.

In order, therefore, to diminish the risk to Indian commerce of a recurrence of such stringency, and in order to reduce the average rate charged for the local use of money, they recommended that the soundest policy was *to attract capital to India from the gold standard countries* which had capital to lend, and this could best be achieved by a gold standard and a stable exchange.

Besides, in order to develop and reap the benefit of her natural resources, India required, and must long continue to require, foreign capital. Such capital could only be drawn from the gold standard countries, and the capital of these countries could only be attracted by a moderate rate of interest or profit on condition, that the investor was satisfied, that there was not likely to be a fall in the sterling exchange.

WAS ACCUMULATION OF SUFFICIENT GOLD POSSIBLE? :—The next question to be solved by the Committee was whether it would be practicable to have sufficient gold for the establishment

of a gold standard. The Government of India pointed out that it was extremely unlikely to accumulate sufficient gold for the purpose, but the Committee proved by statistics that it was otherwise. At this time, when they considered the question, the amount of gold in the Paper Currency Reserve was £2,378,609 which was considered as a substantial addition to the Indian currency. Besides, by the sale of Council Bills the Government of India was able to remit, without disturbing the money market, nearly £18,712,454 worth gold to the Secretary of State.

If such results could be secured in the face of mistrust, it was argued that even greater success might be expected in the future with the growth of confidence. The question, therefore, arose : Should the *status quo* be allowed to continue until events forced the Government to take action? The Committee declared itself against the *status quo*. To have matters as they were, specially after the Government of India had formulated proposals to curtail the transition period and had aroused public opinion on them, would be to create additional uncertainty and withdrawal of confidence in Indian monetary future.

On these grounds the Committee recommended the effective establishment of a gold standard.

## PART IV—Should there be a Gold Standard without a Gold Currency?

The Committee then considered two schemes which were proposed for establishing a gold standard *without* a gold currency.

### (1) Mr. Lesley Probyn's Scheme.

Mr. Lesley Probyn laid great stress upon the *hoarding habits* of the natives of India ; and in view of the direct

encouragement which a gold currency might give to the hoarding of gold, he represented before the Committee that, "if gold coins were passed into currency, it would be at first like pouring water into a sieve". Accordingly he proposed :—

(i) to issue such notes only in exchange for gold;
(ii) to institute a separate issue of *gold notes* of the denomination of Rs. 10,000;
(iii) to make them payable (at the option of the holder) either in rupees or in gold;
(iv) to make it optional to the currency department, when gold is demanded, to pay either in sovereigns or in gold bars of not less than £67;
(v) to issue notes of *smaller denominations* as usual, but these were to be redeemable in *silver rupees only*.

By this scheme it was hoped that gold would be attracted to India, and that a gold reserve would be gradually accumulated which would be strong enough to allow the Government to undertake ultimately the universal convertibility into gold of all rupees and rupee-notes, when presented in parcels of not less than Rs. 10,000. Under this scheme the gold standard would be left to automatic agencies to establish itself, and its establishment would coincide with an ultimate undertaking to exchange rupee currency for gold bars of high value.

THE COMMITTEE REJECTED THE SCHEME :—The Committee pronounced its opinion against this scheme.

In the first place, as regards the hoarding difficulty in India, they were not satisfied that the danger therefrom was so great as was suggested. *Even under silver monometallism India imported and absorbed gold and would be expected to do so in the future, no matter what her system of currency.* In a strongly conservative country like India, no sudden changes were to be expected in the

habits and customs of the people, particularly as regards currency and hoarding. And, until gold had penetrated into general circulation (so far as the relatively small transactions of India permitted), there would be no materially increased temptation to the people to hoard gold instead of silver.

Moreover, the introduction of a gold currency into India was *not to be an untried experiment.* Gold coins were in common circulation in India even before 1835 and formed the principal currency of various parts of the country. "If hoarding" they wrote, "did not render a gold circulation an impossibility in the past, we look for no such result in the future. *The hoarding habit, in short, did not present such practical difficulties as to justify a permanent refusal to allow India to possess a gold currency."*

Besides, while bullion was an admitted international medium of exchange, there was, according to the Committee, no precedent for its permanent adoption for purposes of internal currency, nor did it accord with either European or Indian usage that the standard metal should not pass from hand to hand in the convenient form of current coin.

**(2) Mr. A. M. Lindsay's Scheme (The Gold Exchange Standard).**

ITS CHIEF AIM :—Mr. A. M. Lindsay, Deputy Secretary of the Bank of Bengal, suggested a scheme of currency which would do away with a gold currency. His chief aim was to propose such a scheme that, when it was found necessary to prevent the rupee from *rising above specie-point,* the rupee currency could be expanded ; and when it was found necessary to permit the rupee from *falling below specie-point,* the rupee currency could be

*contracted.* In short, the system was to be automatic in order to keep exchange steady.

We have already seen that the Act of 1893 made provision for preventing the rupee from rising above 1*s.* 4*d.* by making it binding on the Government to give rupees in exchange for gold or gold sovereigns ; but that no provision was made to prevent exchange from falling below specie-point. *Mr. Lindsay's aim was to remove this deficiency by compelling the Government of India to give sterling (and not gold) in exchange for rupees.*

The essentials of the Scheme:—(1) A loan not exceeding £10,000,000 was to be raised in London and the amount was to be kept as a gold standard *reserve* in an office called the London Gold Standard Office.

(2) The Government of India would sell to applicants in India *sterling drafts* on London for not less than £1,000 at the rate of 1*s.* 3¾*d.*, per rupee, and these were to be paid from the reserve located in London.

(3) On the other hand, the London office would sell to applicants in London rupee drafts on the Indian offices for not less than Rs. 15,000 at the rate of 1*s.* 4$\frac{1}{16}$*d.* per rupee, and these were to be paid in rupees at Calcutta and Bombay.

(4) If an excess of rupees accumulated as the result of selling drafts (*i. e.* if the reserve in London were depleted) the excess would be sold as bullion and the proceeds to be credited to the reserve in London; if, however, the stock of rupees were insufficient in India, silver would be purchased out of the London reserve and sent to India to be coined in rupees.

Thus, if at a particular time contraction of currency was found to be necessary to keep exchange steady, sterling drafts would be sold in India for rupees, and rupee currency would be consequently withdrawn from circulation ; if, on the contrary, expansion of currency was necessary rupee drafts would be sold in London which would be paid for in rupees in India, so that rupee circulation would be increased.

It may be noted that rupees were to continue to form the circulating medium in India, gold not being admitted to legal tender.

THE FOWLER COMMITTEE REJECTED THE SCHEME :—The Fowler Committee rejected this scheme more or less on the same ground as Mr. Probyn's bullion scheme. "It is evident," they wrote, "that the arguments which tell against the permanent adoption of Mr. Probyn's bullion scheme and in favour of a gold currency for India, tell *more strongly against* Mr. Lindsay's ingenious scheme for what has been termed *"an exchange standard."* The Committee were impressed by the evidence of Lord Rothschild and others that *any system without a visible gold currency would be looked upon with distrust.* In face of this expression of opinion they concluded :—

(1) that the adoption of Mr. Lindsay's scheme would *check that flow of capital to India* upon which her economic future so greatly depended ;

(2) that, if any system were to be permanent, it would base India's gold standard for all time *on a few millions of gold* (or rather command over gold) in London, with a liability to pay out gold in London, in exchange for rupees received in India, to an indefinite extent.

This was the main reason which made the Government of India[1] reject the scheme and the Committee found full justification for their decision.

[1] Other arguments against the scheme were stated by Sir James Westland, the Finance Member, who in a minute to the despatch of the Government of India wrote: (1) that a gold reserve intended to support the introduction and maintenance of a gold standard in any country ought to be kept in the country, if it is to produce its full effect in the way of establishing the confidence which is almost indispensable to the success of the measure. If the Indian gold reserve is located in London and the public believe that it may at any time vanish in supplying the requirements of trade or of the Secretary of State, confidence will hardly be established; (2) that the scheme did not provide for sufficient control over the exchange.

## PART V—Recommendations of the Committee.

We have now to consider the recommendations of the Committee.

### (A) Gold currency for India.

Their most important recommendation was that the *British Sovereign* should be made a legal tender and a current coin in India. They considered that, at the same time, the Indian-Mints should be thrown open to the *unrestricted coinage of gold* on terms and conditions such as governed the three Australian Branches of the Royal Mint. The result would be that, under identical conditions, the sovereign would be coined and would circulate both in England and in India.

Thus, the *Sovereign* was to be the standard coin of India. "Looking forward as we do to the *effective establishment in India of a gold standard and currency based on the principles of the free inflow and outflow of gold,* we recommend these measures for adoption."

### (B) Convertibility of the Rupee.

But under an effective gold standard the rupee would become a *token coin,* subsidiary to the sovereign. In principle the existence of token coins postulates that they should be *limited legal tender*.

In the case of the rupees the Committee decided that conditions then prevailing in India did not warrant the imposition of a limit *i. e.* they were to be left unlimited legal tender. What was the reason on which they based their decision? They stated that, if there were a limit placed on the *total issue of rupees* in circulation, it would make the rupee permanently exchangeable for gold at a fixed rate, and consequently there would be no necessity of making the rupee limited legal tender. The experience

which had been gained since the closing of the Indian mints to the free coinage of silver supported the belief that this result could be attained.

They quoted two principal instances of countries with a gold standard and currency, which admitted silver coins to *unlimited* legal tender. These countries were France and the United States of America, which did it successfully by keeping their mints closed to the free coinage of silver. The special difficulty in the case of India was one of degree and not of principle.

They, therefore, thought that keeping the Indian mints closed to the free coinage of silver was an *adequate restriction*, and that it made it unnecessary to put any limit on the amount for which tokens were a tender by law.

(1) This being the case, they recommended that the Government of India should not be bound by law *to give gold in exchange* for rupees for internal purposes. The reason was this : such an obligation would impose on the Government a liability to procure gold at a moment's notice to an amount which could not be foretold, and this would necessitate borrowing of gold at a heavy sacrifice.

(2) But they recommended that as the principal use of the gold reserve was that it should be freely available for *foreign remittances when the exchange fell below specie-point, the Government of India should make its gold available for such a purpose, when a necessity arose for its export.*

(3) Besides, the Government should continue to *give rupees* for gold, but fresh rupees should not be coined until the proportion of gold in the currency was found to exceed the requirements of the public.

(4) Finally, in order to have sufficient gold for making it available to the public for export, they recommended

the formation of *a gold reserve*. They wrote, "We also recommend *that any profit on the coinage of rupees* should not be credited to the revenue or held as a portion of the ordinary balance of the Government of India, *but should be kept in gold as a special reserve* entirely apart from the Paper Currency Reserve and the ordinary Treasury balances".

**(C) The Sterling rate for the Rupee.**

But what was to be the fixed relation which, under a gold standard for India, the rupee was to bear to the Sovereign? The Committee, excepting two of its members,[1] recommended that the ratio should be 1*s.* 4*d.* per rupee on the following chief grounds :—

(i) that it was the rate then prevailing and that the continuance of the existing arrangements, under which no fresh rupees were coined except in exchange for gold at a fixed rate, must tend more and more to establish the exchange at that rate ;

(ii) that in 1898-99 at 16*d.* rate of exchange, as we have pointed out, an enormous volume of export trade was achieved without any monetary stringency and a sufficient amount for the gold reserve was accumulated ;

(iii) that prices in India might be assumed to have adjusted themselves to 16*d.* rate and that there was no sufficient reason for altering the existing relations of prices and the essential conditions of contracts expressed in Indian currency.

Thus, they concluded that experience gained since 1893, and particularly that of the eighteen months before writing the report, appeared to them to justify the anticipation that the 1*s.* 4*d.* per rupee rate possessed elements

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[1] Two out of the eleven members of the Committee, Messrs. Robert Campbell and John Muir, recommended the 1*s.* 3*d.* per rupee rate.

of permanent stability and would be maintained in the future.

**Synopsis of the Recommendations:—**

The main recommendations of the Fowler Committee were the following :—

(*a*) that the *British Sovereign* should be made a legal tender and a *current coin in India* and that Indian Mints should be thrown open to the unrestricted coinage of gold. Their real object was the *effective establishment in India* of a *gold standard and currency based on the principles of the free inflow and outflow of gold ;*

(*b*) that Government should continue to give rupees for gold but *fresh rupees should not be coined until the proportion of the gold in the currency was found to exceed the requirements of the public ;*

(*c*) that any profit on the coinage of rupees should not be credited to the revenue or held as a portion of the ordinary balance of the Government of India but *should be kept in Gold as a special reserve* entirely apart from the Paper Currency Reserve and ordinary Treasury balance ;

(*d*) that when the Government has accumulated a sufficient gold reserve and so long as gold is available in its Treasury, *it might discharge its obligations in India in gold* instead of rupees ;

(*e*) that the relation of the sovereign to the rupee should be 1*s*. 4*d*. *per rupee ;*

(*f*) that the *rupee,* although made a token coin, should be kept *unlimited legal tender.*

# BOOK II

## *The Twentieth Century*

# CHAPTER IV.

## Pre-War Period (A)—1900-1907.

### Departures from Fowler's Recommendations. (Drifting towards the Gold Exchange Standard.)

THE ACT OF 1899 :—The recommendations of the Fowler Committee were accepted in their entirety by the Indian authorities and the Indian Coinage Act No. XXII of 1899 made the sovereign and half-sovereign legal tender throughout India at Rs. 15 to the £, and thus gave effect to its first recommendation. Active steps were also taken to give effect to the second recommendation of the Committee, *viz.* the opening of a mint for the coinage of gold in India.

It now remains to consider the history of events since 1899.

(A) IDEA OF A GOLD MINT IS DROPPED :—In the first place, a gold mint could not be instituted without the sanction of the Royal Mint, as the English Sovereign was to be standard coin in India. But far from giving the sanction, the British Treasury objected[1] to the establishment of a gold mint in India on various grounds. They did not think that sufficient gold would be available in India to enable the Mint to continue for a long time, nor did they think it advisable to let the Indian Treasury bear the cost of the mint.

But apart from this technical difficulty, they questioned the very necessity of a gold mint for India. Besides events after 1899, which we shall presently show, went against its establishment.

(B) THE RECOINAGE OF SILVER :—The

[1] Wadia and Joshi: *Money and the Money Market in India*, page 199.

scheme was, therefore, dropped after nearing completion in 1902. In spite of the fact that gold coins were now legal tender in India, a curious situation arose. *The people continued to demand rupees, and the sovereigns returned to Government Treasuries.* Various causes conspired to bring this about.

There was, in the first place, the general monetary stringency. As no new rupees were coined after 1893, with the growth in business, the stringency was bound to be felt.

Then there were the consequences of the Act of 1898.[1] This act authorized the issue at the rate of Rs. 15 to the £ of notes in India against gold deposited in London and earmarked at the Bank of England as part of the Paper Currency Reserve. This additional issue of currency against gold tendered in London *added to the drain* on the *rupee reserves* of the Government of India.

In view of this drain, the Government of India made an active effort to induce the people of India to use sovereigns as a medium of exchange. The currency offices were instructed to offer sovereigns to presenters of notes, and to give rupees to those who objected to receive sovereigns ; and, at the same time, the Post Offices and other institutions were utilized to press sovereigns on the public. But all was in vain. Many of the gold coins made their way back to the Treasury, and the Government found themselves unable to cash currency notes in rupees at various centres. Both notes and sovereigns became subject to a discount in many places.

Unfortunately, *famine* conditions also led to a special demand for rupees and aggravated the general monetary stringency. Sir Edward Law, the Finance Minister,

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1 Chamberlain Commission Report, para 24.

laid great emphasis on the effects of famine on the demand for rupee currency. In his minute of 6th September, 1900, he wrote, "the great bulk of the population is purely agricultural. The agriculturist, in ordinary times, has little requirement for money in the shape of silver coin ; he is himself the producer of a large proportion of the food he consumes, and his other wants which must be satisfied by purchase are trifling. In seasons of famine, however, the situation is changed. The food consumed by the suffering agriculturist must be purchased and paid for with coin, and as credit dries up in times of distress all his other requirements must equally be paid for in cash." Under these abnormal circumstances the Government of India resumed the coinage of rupees early in 1900 on a considerable scale. [1]

(C) THE USE OF SPECIAL RESERVE IS CHANGED. (The Gold Standard Reserve.) :—The third recommendation of the Committee was that the profits on the coinage of rupees should be set apart and kept in gold as a special reserve. *The Gold Standard Reserve,* as it came to be called, was the outcome of this recommendation. The Government of India proposed the formation of a special reserve in September, 1900. Sir Edward Law, the Finance Member, wrote a minute on 28th June, 1900, and the

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[1] That gold returned to Government Treasuries under *abnormal* conditions and that gold currency would have been effectively established if time had been allowed for normal conditions to establish themselves, is proved from the confident statements made by Sir C. E. Dawkins in his Financial Statement for 1900-01. He stated, "I believe that the rate at which gold is taken is likely to increase slowly, and that gold will pass gradually into general circulation in our seaports and large towns. No expectation was ever formed, nor is there any reason to desire, that gold would penetrate into the interior, or that the large mass of transactions in the country would ever be conducted except through the medium of silver and copper. Gold is behaving very much as we anticipated."

(Wadia and Joshi : *Money and the Money Market in India,* page 204.)

principles he laid down therein, decided the future of the currency policy—the establishment of the Gold Standard Reserve. He proposed that—

(1) a maximum limit should be put on the gold in the Paper Currency Reserve, which was to be £7,000,000. Any excess over this amount should be utilized for purchasing silver;

(2) a special gold reserve should be formed by the accumulation of entire profits on the coinage of rupees, apart from the Paper Currency Reserve and the balance of the Government;

(3) the annual interest on the investment of the Paper Currency Reserve should be credited to the special reserve.

Their idea seems to have been to keep the reserve in gold locked up in a special chest in India.

(1) But the Secretary of State decided that the profits should be *remitted to London and invested in sterling securities*. It was held that, since London was the place in which the reserve would have to be applied on the occasion of the emergency against which it was created, London would be the best place in which to keep it.

For the first few years from 1901 onwards, the profits on the coinage of rupees were accordingly remitted to London for investment, the gold being taken out of the accumulation in the Paper Currency Reserve in exchange for the rupees freshly coined. The interest earned on the securities was also added to this gold reserve.

(2) In 1905 the sterling resources of the Government of India in London were further increased by the shipment to London of £5,000,000 out of the stocks in the Paper Currency Reserve in India, to be held as a part of that reserve in *London*. "The advantage claimed of shipping these sovereigns and others in course of years to London and keeping them there was that they could be used there, as and when required, in purchasing silver, thus saving

three or four weeks' delay involved in shipping them from India at the moment when actually required." [1]

(3) In 1906 another innovation was made. The difficulty in meeting the demands for rupees led to the formation in India of a special reserve besides the Paper Currency Reserve. This reserve was to be in coined rupees and was to be formed from a part of the profits on the coinage of the rupees. Thus were formed two branches of the gold reserve, (a) in the form of rupees in India and (b) in the form of sterling securities in London. The name of this reserve was thereupon changed to the *Gold Standard Reserve* which consisted of these two portions.

(4) In June, 1907, a Committee, known as the *Mackay Committee,* appointed by the Secretary of State to consider the question of Indian Railway Finance, recommended that £1,000,000 out of the profits on the coinage in 1907 should be devoted to the provision of adding rolling stock and other improvements for Indian railways, as there was very urgent need of development in that direction. And in making this proposal they put before the Government the object of the Gold Standard Reserve.

In spite of this, the Mackay Committee justified their recommendation on the ground that even after drawing £1 million from the Gold Standard Reserve there would be sufficient gold left to meet the eventuality of a falling off in the demand for Council Bills. But the Secretary of State went beyond their recommendation and decided that for the future *one half* of any profits on the coinage of rupees should be used for capital expenditure on railways until the Gold Standard Reserve reached £20,000,000. It was apparently contemplated that,

[1] The Chamberlain Commission Report, para 29.

after that total had been reached, all profits on the silver coinage should be diverted from the reserve. In spite of protest from the Government of India, he diverted £1,123,000, and adhered to his decision with regard to the future use of the profit on the coinage. But a serious crisis occurred in 1907-08 which made him change his decision.

The action of the Secretary of State shows that the definite object of the Gold Standard Reserve, *that of stabilizing the gold value of the rupee,* and thereby successfully working out the gold exchange standard, (which we shall study later), was not as yet thought out clearly.

(D) THE FUNCTION OF THE PAPER CURRENCY RESERVE IS DIVERTED :—When the coinage of rupees had to be resumed early in 1900, recourse to the London silver market became necessary and silver was bought with the gold held in the Paper Currency Reserve in London. A provision authorizing the Government *to use the gold held in the Paper Currency Reserve* for the purchase of silver for coinage was included in the Act of 1898, which was continued for two years. But an Act of 1902 made the whole of these provisions permanent, although they were issued during times of emergency. Thus *the function of the Paper Currency Reserve,* of supporting the convertibility of the notes, was *diverted to that of buying silver for coinage.*

(E) DIVERTING GOLD FROM INDIA :—Meanwhile, the practice of shipping to London gold accumulated in the Paper Currency Reserve in India was recognized to be needlessly expensive. The gold, it was seen, reached India in the first place at the cost of individuals, and then had to be shipped back to London by and at the cost of

the Government after the public had handed it on to the Government in exchange for rupees. If the practice of receiving gold in London in exchange for rupees in India were extended, Indian revenue could be saved the expense of shipping gold to London, and a large part of the cost of sending gold to India could be realized in the selling price of the Council Drafts.

(1) Accordingly the practice introduced in 1898 of selling the Council Drafts for gold in London, and issuing notes against such gold in India, was extended, and since 1904 the Secretary of State kept open a standing offer to sell Council Bills without limit (*i. e.* over and above his requirements) at the price of 1*s.* $4\frac{1}{8}$*d.* which was the normal gold export point from London to India.

(2) Moreover, the Secretary of State increased the sale of the Bills by selling them below the gold export point.

What was the economic result of the sale of Council Bills without limit and below gold point? In normal times one of the methods of paying for India's favourable balance of trade was by the remittance of gold bullion and sovereigns to India. But by the limitless sale of the Council Bills, and their sale below gold export point, gold bullion and sovereigns were prevented from flowing to India.

### SUMMARY

*Thus the divergence made from Fowler's Scheme were as follows :—*

(1) The scheme for a gold mint was dropped.

(2) The recoinage of rupees was indulged in during this period.[1]

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[1] "The effects of heavy coinage are cumulative. The Indian authorities do not seem to have understood this. They framed their policy as though a community consumed currency with the same steady appetite with which

(3) The location and use of the Reserve formed from the profits on the coinage of rupees were diverted :
  (*a*) The Gold Standard Reserve was invested in securities in London.
  (*b*) The silver branch of the Gold Standard Reserve was formed.
  (*c*) A part of the Gold Standard Reserve was diverted to the Railway capital expenditure.
(4) Council Bills were sold without limit, and at times, at something below gold point against the currency reserve, thus preventing gold from flowing to India.
(5) The gold of the Paper Currency Reserve was used to buy silver for coinage.

### Period (B)—1907-1914.

### PART I—The Crisis of 1907-1908 (and the completion of the Gold Exchange Standard).

GOLD STANDARD RESERVE MAINTAINS EXCHANGE :—In 1907-8 various adverse circumstances led to a crisis in exchange in India ; and for the *first time* since the rupee was fixed at 1*s*. 4*d*., the Gold Standard Reserve and the other sterling resources of the Government of India were utilized in maintaining *the exchange value of the rupee. Thus was completed the mechanism for the successful working of the Gold Exchange Standard.*

CAUSES OF THE FALL IN EXCHANGE :— During the year various causes brought about a fall in the exchange value of the rupee :—

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some communities consume beer.'' (Keyne's *Indian Currency and Finance*). This points to the fact that there was over-issue of coined rupees during this period.

The summer monsoon of 1907 had partially failed and our exportable commodities diminished as a consequence.

To this was added a serious financial crisis in America, which resulted in a general monetary stringency all over the world, and the Bank of England was actually compelled to raise its rate of discount considerably.

Both these causes resulted in a heavy fall in the demand for the Council Bills and for some months none could be sold. The Indian exchange began to fall steadily until it reached the lowest point : 1*s*. $3\frac{11}{16}$*d*. (on 25th November).

WHAT SHOULD HAVE BEEN THE REMEDY? :—What should have been the best remedy for strengthening a falling exchange? The Government of *India should have given gold freely for export to* those who had to meet their liabilities in England. Those who needed gold would have paid for it in rupees *i. e.* rupees would have been withdrawn from circulation and gold would have come out of the reserves, and as a consequence, the exchange value of the rupee would have risen. Even the Fowler Committee had laid great stress on the giving away of gold freely for export in the case of a weak exchange.

THE STEPS TAKEN BY GOVERNMENT OF INDIA :—But the steps taken by the Government in the beginning were different.

(*a*) The Government of India were asked by the Exchange Banks to sell telegraphic transfers on London at Rs. 15 to the £, but after consulting the Secretary of State they refused to do so.

(*b*) Then the Government of India refused to give gold from the Paper Currency Reserve for export in larger quantities than £10,000 to any one individual in one day.

(*c*) The British Postal orders for £10,000 and other

large sums began to be bought as a means of obtaining remittance to London.

(*d*) But the situation did not improve, and businessmen and banks continued to clamour for gold for export. Ultimately (it was not till 3rd December, 1907), the Secretary of State was induced by the Government of India to permit them to give gold for export, although they continued to give gold for internal purposes. And the Secretary of State, being unable to sell Council Bills, released gold from the Paper Currency Reserve in London against the transfer of an equivalent amount of rupees from the Treasury balances to the Paper Currency Reserve in India. These actions, therefore, improved exchange a little.

(*e*) Although the normally busy season went on, rates remained weak and the situation did not improve, and it was decided on the 4th March, 1908, to make weekly sales *in India* of a certain maximum quantity of *sterling bills* on London at the fixed rate of 1*s.* 3 29/32*d.*, and on the 26th March, 1908, such bills were first sold. Meanwhile, the Secretary of State had taken steps to realize some of the securities belonging to *the Gold Standard Reserve* in order to have money ready to *meet the bills sold in India.* These Bills continued to be sold freely in India until (on 11th September, 1908) the exchange appeared to have been sufficiently strengthened owing to a good monsoon, and the Government of India discontinued them.

In all, £8,058,000 were withdrawn during this period from the Gold Standard Reserve to meet these Reserve Bills, and in India, by the sale of these Bills, more than Rs. 12 crores were withdrawn from circulation, in order to strengthen the exchange.

The total gold resources used in India and London together during this one year of crisis amounted to nearly £18,000,000.

THE LESSONS OF THE CRISIS :—The experience of the crisis taught various lessons, which had an important bearing on the future of Indian Currency.

The first serious lesson learnt was that the authorities had failed to recognize the wisdom of the recommendation of the Fowler Committee which was that the principal use of a gold reserve is that it should be freely available for foreign remittances whenever the exchange falls below specie-point.

The second lesson learnt was that the Government should formulate, in advance, the policy it intended to follow during a crisis, and give ample publicity to it. "It is almost as important that the general public should have confidence in the determination of the Government effectively to use their resources to maintain the rupee at 1*s.* 4*d.*, as it is that the Government should have the necessary resources for so doing."[1]

Besides, the crisis revealed the nature of the Indian Currency system, which was more like the system advocated by Mr. A. M. Lindsay in 1898 and which was rejected by the Fowler Committee. The machinery employed to establish the exchange value of the rupee based the system on what is generally known as the *Gold Exchange Standard.*

The rupee was established by this mechanism, *but the result was not obtained without considerable cost,*[2]

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[1] Chamberlain Committee's Report, para 52.

[2] Howard: *India and the Gold Standard,* pages 35-36.

"In London the sovereigns in the currency chest were reduced from £7 millions to £1½ millions; Reserve securities to the value of £8,100,497 were put on the market, and all interest on investment was paid away as

*and the struggle imposed a severe drain on the gold resources of India.*

## PART II—Currency Policy, 1909-1913.

### Gold Currency or Gold Exchange Standard for India?

We just saw above that the gold reserves of the Government of India suffered severely in the attempt to raise the exchange value of the rupee. This, therefore, aroused strong public criticism, and the Government of India found it necessary to revise the currency policy and entered into long correspondence with the Secretary of State over it.

POLICY PROPOSED BY GOVERNMENT OF INDIA (*A Gold currency*) :—The Government of India, on their part, wrote strongly in favour of the following :—

(*a*) In the first place, in their despatch of 1st April 1909, they pleaded for a *larger Gold Standard Reserve* to meet greater emergencies than that of 1907-8. They considered that the minimum amount in the Gold Standard Reserve should be £25 millions, apart from the gold in the Paper Currency Reserve and Treasuries and that, therefore, the profits on the coinage of rupees should not be diverted to the capital expenditure on railways until this limit was reached.

(*b*) They also proposed that a substantial bulk of the Gold Standard Reserve should be kept in a *liquid form*, instead of being invested in securities, because, during a crisis, the latter could not be readily realized and gold made available, or realized without considerable loss.

(*c*) The Government also urged the importance of *holding a large amount of gold in India, and* proposed

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it accrued. In India the entire stock of gold was exhausted. In October 1907 when the trouble began, the currency chests, treasuries and mints held £4½ millions of sovereigns. On March 31st, 1908, the stock had fallen to £100,000 and all further issues had been stopped."

that at least two-thirds of the total gold (£13,000,000) held in the Paper Currency Reserve, should be kept in India; and that until this limit were reached, the Secretary of State should not add to the gold in the Paper Currency Reserve in London. In support of this, in their despatch of 30th September, 1909, they wrote:—"Though gold was still far from having obtained that popularity which the interests of exchange render desirable, *there were indications of a greatly extended use of the sovereign in commercial transactions.* It was estimated, for instance, by our Controller-General that it might shortly be possible to finance in gold no less than 20 per cent. of the up-country cotton trade of Bombay. This promising development has naturally received a severe check as a result of recent events. We, therefore, judge it to be eminently desirable to increase the local gold holding in our Paper Currency Reserve. *We could face another exchange crisis with far greater equanimity could we be assured both of an active circulation of sovereigns in the country and of a strong reserve in our currency chest.* The former will enable the ready export of superfluous currency, which the strength of our own reserve would enable us at once to assist this process, and, by free uses of gold, to bring about that restoration of public confidence which is of vital importance in the early stages of a panic."

(*d*) As an outcome of the resolution moved in 1912 by the late Sir Vithaldas Thackersey in the Imperial Legislative Council, the Government of India in their despatch of 16th May, 1912, asked the Secretary of State's sanction for the *coinage of sovereigns* at the Bombay Mint.[1]

[1] Sir Vithaldas Thackersey moved a resolution in the Imperial Legislative Council to the effect that the Indian Mints might be thrown open to the

THE SECRETARY OF STATE CHAMPIONS THE GOLD EXCHANGE STANDARD :—We have now to see how far these recommendations received the approval of the Secretary of State.

(A) As regards the amount of gold to be kept in the Gold Standard Reserve, the Secretary of State agreed, after great persuasion, that £25 millions should be the standard before the profits on coinage could be diverted.

(B) But he did *not* agree to the proposal to keep a substantial part of the Gold Standard Reserve in a liquid form, except for the amount £1 million, which he decided to let out in short loans or to put into bank deposits. Of the balance he would hold a considerable portion in high class securities with a near date of redemption, and the remainder in Consols or other approved stock.

(C) As regards the strengthening of the gold in the Paper Currency Reserve and its location, the Secretary of State decided that it was more advantageous to *hold it in London* than in India. In support of this decision he stated that if the rate of exchange fell so low that it led to the suspension of the sale of Council Bills in London, gold in *circulation in India would be of little or no use for supporting exchange,* at any rate, immediately, since it would probably not be exported, and would obviously not be available towards defraying the Home Charges. On the other hand, he showed the advantages of holding gold in London and wrote :—

"Gold held in England is available for supporting exchange not only when the rate falls to gold export point (when it can be used for meeting bills on London sold in India), but also at the earlier stage when the rate has

free coinage of gold, and he suggested the coinage of a ten-rupee gold coin. On the Government assuring him that the Secretary of State would be approached with a request to that effect, the resolution was withdrawn by him.

fallen only to the point at which the suspension of Council Bills is desirable (when it can be used towards defraying the Home Charges). The stock is not liable to be depleted by any cause corresponding to the disappearance into hoards of gold in India. When the demand for remittances is strong, gold in England is available for any purchase of silver that may become necessary.''

He, therefore, was unwilling to commit himself to a postponement of any increase of the stock of gold in England.

(D) With regard to the proposal for the minting of gold coins in India, the Secretary of State suggested the coinage in Bombay of a ten-rupee gold coin to avoid various difficulties that had arisen with His Majesty's Treasury. But the minting was postponed until the decision on it was given by the Chamberlain Commission, which had already been appointed.

CONCLUSIONS :—Two conclusions follow from these discussions on the currency policy :

(1) that, although the Government of India pleaded for a gold standard with a gold currency for India, *the Secretary of State decided in favour of the Gold Exchange Standard;*

(2) that it was left for a Royal Commission to give its blessings to the Gold Exchange Standard by giving it permanency, and the *Chamberlain Commission was appointed.*

## PART III—Findings of the Chamberlain Commission (1913-14).

**(The Gold Exchange Standard was most suited to India.)**

The strong feeling in India with regard to the new currency policy evolved after 1899, and the difference of opinion between the Government of India and the Secretary of State on the same, meant that time was ripe for the establishment of a Royal Commission. A Com-

mission was appointed in April, 1913, with the Right Hon. Mr. Austen Chamberlain as the Chairman, and it reported in February, 1914. Of the ten members of the Commission, one member of great practical monetary experience in India, Sir James Begbie, wrote a dissenting minute entirely disassociating himself from the conclusions and recommendations of the majority.

THE TERMS OF REFERENCE :—They were asked to enquire into the following :—

> The location and the management of the general balances of the Government of India; the sale in London of Council Bills and transfers; the measures taken by the Indian Government and the Secretary of State for India in Council to maintain the exchange value of the rupee in pursuance of or supplementary to the recommendations of the Indian Currency Committee of 1898, more particularly with regard to the location, disposition, and employment of the Gold Standard and Paper Currency Reserves; and whether the existing practice in these matters was conducive to the interests of India; also to report as to the suitability of the financial organisation and procedure of the India Office; and to make recommendations.

Of these we shall deal with only those that are obviously *currency* matters, leaving aside financial matters.

## SECTION I—Arguments in support of the Gold Exchange Standard.

(1) In the first place, the Commission gave a summary of Indian Currency History from 1893 (which is not necessary to reproduce), and decided in favour of the continuance of the Gold Exchange Standard.

According to them, *force of circumstances* compelled the Government to evolve a new system, which was contrary to the one sanctioned by the Fowler Committee. The system actually in operation (the Gold Exchange Standard), they stated, had never been deliberately adopted as a consistent whole, nor did the authorities

themselves appear always to have had a clear idea of the final object to be attained. To a great extent *this system was the result of a series of experiments.* But to state this was by no means to condemn the action or the system actually in force.

Then there is the admission that the authorities were subject to mistaken ideas which were quickly rectified in practice. But the steps taken to restore and maintain exchange proved adequate. Thus, they stated, "it is easy to see after the event (crisis of 1907-8) that in this or that point a mistake was made, but, regard being had to the difficulties and the novelty of the circumstances, *the final success achieved by the Indian authorities, both in India and in this country*, must be recognised as a proof of the *soundness of the currency scheme itself* and of the measures ultimately taken for meeting the crisis."

In short, their argument was that the crisis of 1907-8 and subsequent experiences had proved that it would be possible to maintain the purchasing power of the Rupee *outside India* at Rs. 15 to the sovereign *without the aid of a gold currency circulating within India.*

SIR JAMES BEGBIE'S REJOINDER :—The Majority had pressed the point that the public preferred and demanded rupees, and the demand had to be met. This, in fact, had been the fundamental difficulty which led to the evolution of the new system of currency. But, Sir James Begbie pointed out that no doubt that was a reason which carried considerable weight in the early years of the period during which the policy had been developed, but *"it had now lost its force"*. The *public had absorbed during the last 12 years, approximately, equal amounts* of rupees and sovereigns, but the demand for sovereigns had rapidly increased during the last four years. These gold

requirements showed *an important* change *in the currency* needs of the people, and indicated a preference for *gold over rupees.*

(2) The second argument stated in support of the Gold Exchange Standard was that the Indian system so far evolved, had close affinities with other currency systems in some of the great European and Asiatic countries, *e. g.* Russia, Holland, Austria-Hungary or Japan. In these countries, as in India, they stated, "*gold actually in circulation is of secondary importance,* and the internal medium of exchange, whether it be a silver coin or a paper note, depends for its value in exchange not on its own intrinsic worth, but on the maintenance in reserve of gold or resources readily convertible into gold, and in the case of Russia and Japan, at any rate, large portions of the gold resources are held not at home, but in London, Paris, and other monetary centres, just as India's Gold Standard Reserve is held in London."

SIR JAMES BEGBIE'S REJOINDER :—"But such analogies," wrote Sir James Begbie, "are unsafe as a guide to Indian policy, because the *conditions are not identical.* (a) In none of those other countries is there the same *private absorption of gold* that there is in India ; (b) Whatever experience elsewhere may be, the recent demands for gold in India *show a loss of confidence on the part of the public in the token rupee,* and that is a situation that should not be ignored. The need for confidence to secure the exchange value of the rupee is recognized, but not the need of confidence in the currency in other respects. It is no longer possible to say that the token rupee is preferred by the Indian public and satisfies their currency requirements in face of the fact that they have latterly exhibited so strong a desire for gold as the

*statistics indicate*. At least there is not now such general confidence in the Rupee as would, in my opinion, alone warrant further large extensions of the token currency."

(3) Another argument given by the Majority was that it was desirable *to educate people in the use of more economical forms of currency than gold.*

SIR JAMES BEGBIE'S REJOINDER :—"That is", wrote Sir James Begbie, "a desirable object. The increased circulation of notes may be pointed to as an advance towards the use of more economical forms of currency ; but it is due, not solely to a desire to economise in currency, but partly at least to increased facilities for the employment of notes. This demand for gold coin, accompanied as it has been by increased demands for gold bullion, dominates the whole currency system. *For a country which takes gold in great quantities an extensive token currency is most unsuitable. It has the usual effect of driving gold out of circulation. It has the still greater disadvantage that it keeps the gold out of useful employment. People who value gold so highly as to store and hold it to the extent witnessed in India are not likely to invest or make other profitable use of it, so long as they have to take the risk of being repaid in token coins when they realise their investments.* The token currency not only prevents the holders of gold from utilising it to some advantage, but the country as a whole loses the benefit that should accrue to it from the possession of great wealth—What is needed is not education in the use of economical currency so much as *education in the use of stored up gold.* The first step, however, is to convince the people that if they use their gold they will get it back when they want it, and that cannot be done while there is this extensive and expanding token currency. A currency

in which gold was a more prominent feature and to which token coins were less freely added would be more practical as an educative force.''

### SECTION II—Reasons advanced against Gold in Circulation.

Having defended the existence and the working of the Gold Exchange Standard, the Majority in their report, gave careful consideration to various arguments put forward by witnesses in favour of gold in circulation. Since some of the arguments recur even to-day, it would be profitable to deal with them at length.

(*a*) The most weighty argument which several witnesses put forward was that *gold in circulation was calculated in the long run to strengthen exchange*. The Majority analysed this argument carefully as follows :

In the first place, some witnesses seemed to imply that, if gold were to be used in India to *the same extent as* in, say, the *United Kingdom or Germany,* the exchange problem would be largely simplified.

In the opinion of the Majority, this was a mistaken belief. Because in these countries the stability of exchange depended on the central reserves of the banks of these countries with their influence on other banks and the money market and their bank policy, and not on gold in the pockets of the people.

If, however, the advocates of gold currency desired that gold in circulation should be used to a *very great extent* as, for example, in Egypt, then the Majority considered that gold would be performing the function of strengthening exchange successfully. For in Egypt a large percentage of the value of the total transactions was carried out in gold, instead of a very small percentage as in the United Kingdom or India ; so that, in case of a

contraction of business a nearly proportionate amount of gold would be released for export. But in order to attain to this position in India, it would be necessary to reduce the note issue to a comparatively insignificant position, and to withdraw from circulation, at large expense, a considerable part of the rupees.

If, however, the advocates desired *that gold should increase gradually* without detriment to the notes and rupees in circulation, the Majority declared that gold must continue to occupy, for many years to come, a subsidiary position in the currency, and exchange would not benefit materially from a circulation of gold on a moderate scale, as was proved by the crisis of 1907-8.

But the question would arise as *to the source* from which the gold was to come. If the gold took the place of new rupees, which it would be necessary to mint, the effect would be to diminish the strength of the Gold Standard Reserve by the amount of the profit which would have been made from the new coinage. This would bring to an end its natural growth. Besides, if gold were to replace notes and rupees in circulation, the consequence would be a rapid depletion of the Paper Currency Reserve which serves as a substantial aid to the Gold Standard Reserve. Thus, the weakening of both the reserves might gravely weaken the Government's position at a time of exchange difficulty, because "*sovereign for sovereign, gold in circulation is less effective than gold in reserve for supporting exchange.*"

SIR JAMES BEGBIE'S REJOINDER :—"That, of course, is true," wrote Sir James Begbie, "but it is equally true that *gold in circulation is a better protection for exchange than token coins*. Gold in circulation can never endanger exchange stability. It cannot be too

strongly emphasised *that danger lies in the token currency alone when unfavourable trade conditions prevail.* In the words of the Report (of the Majority) 'it is the surplus tokens and not the gold which will seek an outlet at times of weak exchange.' "

(*b*) Various witnesses objected to the coinage of fresh rupees because of the danger to exchange of a very large circulation of tokens. But the majority stated that in many respects *gold was a far more formidable rival to the note issue* than to rupees, "since for many purposes a coin of so high a value as the sovereign cannot possibly take the place of rupees. There is some evidence that the popularity of sovereigns did hinder the use of notes in certain parts of India. Whilst experience has shown that a public preference for gold, or alternately for notes, is largely a matter of habit and custom. To habituate a people, therefore, to the use of sovereigns is almost certain in the long run *to militate against the use of notes which is not a desirable goal.* Notes is a more desirable form of currency than gold coins."

SIR JAMES BEGBIE'S REJOINDER :—But Sir James Begbie wrote, "notes will usually be preferred to coin, whether gold or silver, for such purposes as bank cash reserves and for effecting remittances. If the use of notes for other purposes is endangered by a circulation of gold coins, because people prefer the latter, it has to be remembered that the notes may be affected by the growing demands for gold. If the public want gold they will get it whether they hold notes or rupees, and when they prefer gold they are not likely to be satisfied with notes, payment of which can be demanded only in rupees."

(*c*) Certain witnesses argued that gold currency was a

necessary step towards what may be regarded as the ideal currency, *viz.*, paper backed by gold in reserve.

On this argument the Majority stated that history gave no support to the view that a paper currency could only be reached after a gold currency had been in circulation. "A paper currency, if readily encashable, is the most economical medium of circulation, and at the same time provides a readily available reserve of gold for foreign remittances."

(*d*) It was also said by many witnesses that until India had a gold currency in active circulation, India would continue to possess an artificial and *managed currency,* it being implied that a managed system is a bad system. The ideal with which this "managed system" was contrasted was the system of the United Kingdom where there was free coinage and the standard coin could be obtained *by any one* who took gold to the mint for coinage.

The Majority saw no value in this contrast. According to them there did not appear to be any essential difference between the power to import sovereigns at will and the power to have gold coined into sovereigns in India. "In the fact that the rupee is a token which passes at a value above its intrinsic value and is at the same time unlimited legal tender, the Indian currency system may be called managed, particularly because it is not practicable even to consider the limitation of the amount for which the rupee is legal tender. But because it is to this extent a managed system, it is not correct to say that it is a bad system."

(*e*) Besides, the Majority also regarded gold in circulation as *wasteful,* because of the *wasteful habit of hoarding* prevailing in India. "The hoarding habit is sanctioned by the experience of centuries in India and by religious

and racial laws and customs, and until the habit of banking takes the place of the hoarding habit as a means of securing and increasing savings, it would be wasteful to have gold in circulation.''

SIR JAMES BEGBIE'S REJOINDER :—''The hoarding habit in India is indeed a difficult problem. Its recent development in increased demand for gold, and the possibility of its further expansion make it a question of the highest importance.'' But, said Sir James Begbie, *''that is to a large extent the outcome of the policy which has brought into existence token currency.* Up to the closing of the mints in 1893 to the free coinage of silver, the public had been accustomed for generations to *full-value* coins for their currency requirements and *they are not now prepared to hold their profits and savings in the form of over-valued rupees.* Hence their preference for gold, both coin and bullion. The habit is, therefore, not inevitable and is capable of being improved. The statistics show, on the one hand, that great progress has been made in attracting the cash reserves of the people into profitable investments, but on the other, they show a retrograde movement in favour of hoarding due to the *natural desire for solid security* which is not to be had in investments which are made in token currency. It is surely not to the interest of India to have its rapidly accumulating wealth diverted into idle hoards by the token currency policy.''

Besides, *if the gold held in hoards in India was to be attracted into useful employment,* ''it can be done only by providing security that when it is invested the investment will continue to represent gold, and be convertible into gold, by *means of a gold currency policy* in which the public will have confidence.''

(*f*) The Majority also concluded that "India neither demands nor requires gold coins for currency." But this statement called for correction. The fact that India imported, apart from gold bullion, over £60,000,000 in sovereigns in the twelve preceding years (*i. e.* almost as much as the value of the new coinage of rupees in the same period), clearly proved that India did demand and require gold coins. "The fact is that India now demands gold monetary tools as insistently as she used to demand silver tools ; and the reasons are obvious—a growing distrust in the token rupee, and a growing appreciation of the superior attractions of the sovereign as currency."[1]

## SECTION III—Gold Mint for India was unnecessary.

Various witnesses also advocated the institution of a gold mint for India.

Some witnesses recommended a gold mint on the ground that it would *facilitate a flow of gold to India.* But the Majority considered that this argument had lost its weight because gold did flow freely to India without this stimulus, and they doubted if more could have been attracted by mere facilities for coinage.

Others recommended it on the ground that the mere fact of gold being coined in India *would win public confidence* in the stability of the exchange value of the rupee.

But the Majority stated that this consideration had its force in 1899 and 1900, but the experience of 1907-8, the growth of the Gold Standard Reserve, and the whole trend of policy and opinion since 1898, showed how determinately and successfully the Government maintained exchange.

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[1] Indian Finance and Currency (A Note on the report of the Chamberlain Commission) by Sir M. de P. Webb, Para 40.

The idea of a gold mint was also pressed on the ground that it *would increase the amount of gold in circulation.*

The Majority considered that, even if it was thought in itself desirable, the mere existence of a mint for the coinage of gold could not add to the amount of gold available for currency purposes. Nor was it possible that it would encourage gold to come out of the hoards in unfavourable seasons. Indeed, in times of famine and distress, gold did come out of the hoards, but the existence of a gold mint was not likely to increase it. It would come out even in exchange for notes or rupees in difficult times.

If, therefore, the Government of India were to *renew the notification,* withdrawn in 1906, of *their readiness to receive refined gold at the Bombay Mint in exchange for notes or rupees,* it would remove the only practical grievance which could be alleged against the present system in this respect and *would render unnecessary the opening of a gold mint.*

But the Majority stated that "if Indian sentiment genuinely demands it, and the Government of India are prepared to incur the expense, there is, in our opinion, no objection on principle either from the Indian or the Imperial stand-point, provided always that the coin to be minted is the sovereign (or the half-sovereign); and *it is pre-eminently a question in which Indian sentiment should prevail.*"

**Summary of Conclusions and Recommendations.**

I. *The Gold Exchange Standard was suited to India because :*

(*a*) the establishment of the *exchange value of the*

rupee on a stable basis had been of the first importance to India ;

(*b*) *the measures adopted* for the maintenance of the rupee (although necessarily and rightly supplementary to, than in all respects directly in pursuance of the recommendations of the Fowler Committee) *worked well* in the crisis of 1907-8, the only occasion on which they were severely tested ;

(*c*) the most generally suitable media of internal circulation in India were rupees and notes, but the use of notes should be encouraged. The essential point was that the internal currency should be supported for exchange purposes by a thoroughly adequate reserve of gold and sterling.

II. *The Gold Standard Reserve should be strengthened* :

(i) There should be no limit fixed to its amount, and profits on coinage should be credited exclusively to it.

(ii) A much larger portion of it should be in actual gold which should be raised to £15,000,000 and thereafter *one-half of the total reserve should be in actual gold.*

(iii) The rupee branch held in India should be abolished, the rupee being handed over to the Paper Currency Reserve in exchange for gold.

(iv) The proper place of the Gold Standard Reserve was London.

III. The Government should undertake to sell bills in *India* on London at the rate of 1*s*. 329/32*d*.,

per rupee whenever called upon to do so (in case of a fall in exchange).

IV. The Paper Currency system should be made more elastic.[1]

V. *It would not be to India's advantage to encourage an increased use of gold, and Gold Currency was not necessary for India* because :

(*a*) the gold standard had been firmly secured *without a gold currency,* as the history of the last 15 years had proved it ;

(*b*) gold in circulation was wasteful ;

(*c*) gold in circulation was of little or no use in support of exchange ;

(*d*) India should be encouraged to develop economical habits in matters of currency ;

(*e*) India neither demanded nor required gold coins as currency.

VI. *A gold mint was neither required nor was considered necessary for India,* but if Indian sentiment genuinely demanded it, and the Government of India were prepared to incur the expense, there was no objection to it, provided that the coin minted was the sovereign (or the half-sovereign). It was, pre-eminently, a question in which Indian sentiment should prevail.

If, however, the decision was against the opening of a gold mint, *the notification of the Government's readiness to receive refined gold in exchange for rupees or notes at the Bombay mints should be renewed.*

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1 This is considered in Book III.

# CHAPTER V.

## The War Period.

**Period I.**
First shock of the war up to end of 1916.
Dislocation of trade and business

**Period II.**
From end of 1916 to 1919.
Abnormal rise in the rate of exchange and its consequences

FATE OF THE RECOMMENDATIONS OF THE CHAMBERLAIN COMMISSION :—The recommendations of the Chamberlain Commission were receiving the attention of the authorities but in the meantime the War broke out. The Government was, therefore, not able to show its approval of all of them and it was left to the War Period to prove their worth. But action was taken on the following recommendations soon after the War broke out :—

(a) the abolition of the silver branch of the Gold Standard Reserve ;

(b) the steps to be taken in case of a fall in exchange ;

(c) the giving of facilities for the encashment of notes.

THE WAR PERIODS :—The history of Indian currency during the War may well be divided into *two* parts :—

*Period I*. The first period ends with the completion of the year 1916. During this period there was general dislocation of trade and business, as a result of the first shock of the War, with its attendant effects.

*Period II*. The second period begins with 1917 and ends in 1919. This is the period of revival during which,

owing to various causes, the rate of exchange soared very high.

## PERIOD I—From First Shock of the War up to the end of 1916 (Dislocation of trade and business)

THE EFFECTS OF PANIC :—The outbreak of War immediately caused, in India as elsewhere, a panic which led to a general dislocation of trade and business of which the principal symptoms were :

(a) the weakening of exchange ;
(b) withdrawal of savings bank deposits ;
(c) a demand for the encashment of notes ;
(d) a run on Indian gold stocks.

THE MEASURES TAKEN :—(a) The weakening of exchange was met by the proved expedient of offering drafts in India on London, and between 6th August, 1914, and 28th January, 1915, Reverse Council Bills were sold to the extent of £8,707,000 (the Chamberlain Commission had strongly approved of this measure and recommended it for future emergencies).

(b) The net withdrawal of savings bank deposits in the first two months of the War amounted to Rs. 6 crores (out of a total of Rs. $24\frac{1}{2}$ crores on 31st July, 1914) and there were subsequent withdrawals up to 2 crores in spite of some recovery. The net withdrawals for 1915-16 amounted *to nearly Rs. 8 crores*. But, continuous payment restored confidence and the tide turned in 1915-16, and since that date deposits continued to increase with the result that the figure at the end of 1918-19 was Rs. $18\frac{3}{4}$ crores. There was also a run on the banks, but this proved of short duration.

(c) Some lack of confidence in the Indian note issue manifested itself at the outbreak of the war and resulted

*in a net return of currency notes* to the extent of Rs. 10 crores, and there was consequently a substantial fall in the silver held in the Paper Currency Reserve. Thus,

**Paper Currency Reserve.**

| Date | Amount in rupees |
|---|---|
| 31st July 1914 ... ... | 33·94 Crores |
| 31st December 1914 ... | 29·87 Crores |

But from the spring of 1915 there was a steady increase of note circulation.

(d) There arose at the end of July, 1914, a keen demand for gold in exchange for notes and between the 1st and 4th August, 1914, the Government of India lost about £1,800,000 of gold. When precautions to discourage the withdrawal of gold proved unavailing, it became necessary on 5th August, 1914, to *suspend the issue of gold to private persons*.

The disquieting symptoms, however, lasted only for a short time. With the return of public confidence, assisted by the readiness of the Government of India to meet all demands, the currency mechanism began to work smoothly.

## PART II—From the end of 1916 to 1919. Abnormal rise in the rate of exchange and its consequences.

It was not until the end of 1916 that acute complications arose in the sphere of Indian currency and exchange. These complications were so great and varied, and existed at such a critical time, that rarely has another country passed through such a period of strain in its currency history. It is, therefore, of great importance to

trace in details the causes which led to various difficulties in currency matters and the measures taken to overcome them.

SECTION I—**Causes of the rise in the rate of exchange.**

(a) FAVOURABLE BALANCE OF TRADE :—It was well known that the ability of the Government of India to remit to London the funds required for the payment of the Home Charges, and also the successful working of the Indian currency system, depended on the existence of a substantial balance of trade in India's favour. Even before the War began, India had enjoyed a series of remarkably prosperous years, and during War years that prosperity was continued, although it was slightly lesser than in the pre-war years.

| Average of 5 years | Net exports of merchandise on private account |
|---|---|
| 1909-10 to 1913-14 | £ 52,237,200 |
| 1914-15 to 1918-19 | £ 50,387,700 |

But, if we take into consideration the three years 1916-17, 1917-18 and 1918-19, when the Indian currency difficulties were most acute, we find that the average balance of trade in favour of India was decidedly greater than that of the three years preceding the war, as the following Table shows :

| Average of 3 years | Net export of merchandise on private account |
|---|---|
| 1911-12 to 1913-14 | £ 53,429,200 |
| 1916-17 to 1918-19 | £ 59,601,100 |

This was due to the fact that supplies of food-stuffs and raw-materials were required for the use of the Allied Powers and the prices they realized were abnormally high.

There was also a *contraction in imports* concurrently with an increase in exports, because the productive power of the United Kingdom and her Allies was more and more completely absorbed in war industries. *It was only the rise in prices that maintained the value of import trade. Imports from the enemy-countries ceased entirely.*

The large balance of trade indebtedness in India's favour resulted in the strengthening of exchange and *the heavy demand on the Government for currency.*

(b) EXCEPTIONAL DISBURSEMENTS :—*Other special causes were at work to intensify this demand.* India formed the base of important military operations in Mesopotamia, Persia and East Africa. The Government of India was called upon to provide funds for the payment of British and Indian troops engaged and for the expenses incidental to a modern campaign, and for civil expenditure in occupied territory. In five years this expenditure totalled £240,000,000. In addition to the above, arrangements were made for financing of purchase in India on behalf of certain dominions and colonies and for provision of rupee credits, amounting to 20 crores in 1917-18 and 1918-19 for American importers of Indian produce.

(c) HEAVY DECLINE IN IMPORTS OF PRECIOUS METALS :—*These exceptional disbursements created a heavy additional demand for Indian currency.* The precious metals play an important part in the adjustment of India's favourable trade balance, but during the

war years there was a *heavy decline* in the imports of gold and silver.

**Total Imports of Precious Metals into India during**

| | |
|---|---|
| 5 years preceding the war ... | £ 120,242,000 |
| 5 years of the war ... ... | £ 35,984,000 |

Several factors contributed to the remarkable decline in the import of precious metals during the latter period.

The first, and by far the most important, factor was *the difficulty of obtaining gold.* The free market in London, on which India had been able to draw in the past, disappeared on the outbreak of the war. Restrictions on the export of gold were imposed by belligerent Governments desirous of maintaining their stocks of the metal for war purposes, and India was accordingly only able to obtain very limited quantities.

The dearth of gold created a strong demand for silver of which there was a great shortage of supply. The world's production of silver from 1914 onwards exhibited a marked decline from the production of the preceding years. Approximately three-quarters of the world's production of silver was mined in North America and Mexico, and the key to the shortage was to be found in Mexico due to political disturbances in that country.

The decline in the imports of precious metals *threw the burden of liquidating the favourable trade balance on the Government of India.*

(d) ABSORPTION OF RUPEES :—That there was heavy absorption of rupees during the war is shown very clearly by Mr. Findlay Shirras. The following table re-

presents the statistics given by him in his book *Indian Finance and Banking* :—

**Rupee (including half-rupee) Absorption.**
*(In lakhs of rupees.)*

| Annual average | Amount |
|---|---|
| 1909-10 to 1913-14 | 8,78 |
| 1914-15 to 1918-19 | 22,08 |

Here we have an *increase of nearly 250 per cent.* above the pre-war average. 'Such a large absorption is wasteful.'

(e) RISE IN PRICE OF SILVER :—At the same time, the *world's demand for silver was unusually keen,* particularly for coinage. The coinage of the British Empire alone absorbed nearly 108 million ounces during 1915-18, as against 30.5 million ounces between 1910-13. And there were similar increases in other countries, specially in China. Before 1917 China was a seller of silver, but since that year she became an intensive demander of that metal.

We have seen that war conditions interfered with the normal flow of precious metals into India. The burden, therefore, of liquidating her favourable balance of trade was focussed on the Government of India and took the form of *additional demands for currency*. The efforts made to meet these demands are indicated in the following figures :—

| During period | Amount bought by Government of India in *standard ounces* |
|---|---|
| April 1904 to March 1907 . | 180,000,000 |
| April 1916 to March 1919 . | 500,000,000 |

Thus, these large purchases by the Government of India, the decrease in the supplies of silver and the increased demand from other quarters, *led to a rise in the price of silver.*

| Year | | Price of silver per *standard ounce* in London Market |
|---|---|---|
| | | *d.* |
| 1915 ... ... ... ... | | $27\frac{1}{4}$ |
| 1916 (December)... ... | | 37 |
| 1917 (August) ... ... | above | 43 |
| 1917 (September)... ... | | 55 |
| Period of control by U.S.A. and British Governments. September 1917 to May 1919. | Between and | $47\frac{3}{4}$ 50 |
| May 1919, (removal of control) ... ... ... | | 58 |
| 17th December 1919 ... | | 78 |

From the above figures we conclude that the rise in price was continuous, except during the period when the Governments of the United States of America and of Great Britain instituted control over the trade in silver and over its price. In August, 1917, the price exceeded 43d. *It is important to remember that this figure, 43d., marks the point at which the exchange value of the rupee at 1s. 4d. was equivalent to its intrinsic value; so that any rise in price to 43d. and above it necessitated the raising of the exchange value of the rupee* (as we shall see). Since May, 1919, the rapid rise in price of silver was due to the exceptional demands from China.

(f) INFLUENCE OF THE DOLLAR-STERLING EXCHANGE :—There was another factor which tended to raise the price of silver in the London Market. As America had been the principal source of the world's silver supply, the chief payments for that metal had to be made ultimately in that country. Therefore, it had to take account of the London-New York Exchange, and any rise or fall in that exchange would be reflected in the price of silver. Any fall in the sterling exchange would result in paying more sterling for a given quantity of silver than before.

Thus, if the exchange value of the rupee is 2*s.*, the Secretary of State can buy silver for coinage of rupees without loss at 63*d.* per standard ounce. If now the London-New York Exchange fell, say 10 per cent., the sterling price of silver would rise to over 69*d.*, as the direct result of the fall in exchange. Under these circumstances, if silver had to be bought for Indian coinage, the exchange value of the rupee would have to be raised to nearly 2*s.* 2½*d.*

CONCLUSIONS :—Hence, as the price of silver rose steadily, the *exchange value of the rupee had to be raised accordingly*; otherwise, *the intrinsic value of the rupee would be greater than its exchange value, and as a consequence, the rupee would disappear from circulation, or would be melted down or exported.*

Besides this, the heavy *purchases of silver* (due to the heavy and continuous requirements for silver coin) and the *rising prices* at which they had to be made, rendered the Pre-War currency and exchange system impracticable.

## SECTION II—Measures taken by the Government.

Various measures were taken by the Government to meet the difficulties stated above.

(a) CONTROL OF EXCHANGE :—The machinery for regulating exchange had to be changed by force of circumstances.

The Secretary of State had to *put a limit to the sale of the Council Drafts in London on India,* because as the demand for them was abnormal and the Paper Currency Reserve had already fallen, their sales on an abnormal scale would endanger the convertibility of the note issue. But this limitation of the amount of Council Drafts at a time when the demand for remittance to India was exceptionally strong, led to *a divergence* between the market rate of exchange and the rate at which the drafts were sold.

And it was essential that the exports required for war purposes should not be impeded. It was, therefore, found necessary to introduce certain measures of control. The sale of drafts was confined to banks and firms on the "Approved List", which included the chief exchange banks and a few large purchasers of drafts. And these in turn were required to do business on prescribed terms with third parties, and concentrate their resources to financing the export of commodities needed by the Allies for the War.

Thus, the Pre-War system of free and unlimited remittance had to be suspended. But after the conclusion of the Armistice these restrictions were removed, and with the revival of a free market for gold, the old conditions were restored.

(b) RAISING THE RATE OF EXCHANGE :—As we saw before, the rise in price of silver to 43*d*. per

standard ounce and above it, necessitated the raising of the rate of exchange. The following table shows the successive steps of raising the exchange.

| Date of introduction | The minimum rate for immediate telegraphic transfers | |
|---|---|---|
| | *s.* | *d.* |
| 3rd January 1917 ... ... | 1 | $4\frac{1}{4}$ |
| 28th August 1917 ... ... | 1 | 5 |
| 12th April 1918 ... ... | 1 | 6 |
| 13th May 1919 ... ... | 1 | 8 |
| 12th August 1919 ... ... | 1 | 10 |
| 15th September 1919 ... | 2 | 0 |
| 22nd November 1919 ... | 2 | 2 |
| 12th December 1919 ... | 2 | 4 |

(c) PURCHASE OF SILVER :—These modifications in the system would not have been effectual in meeting the situation unless special measures had also been taken to *increase the supply of currency.*

The Secretary of State had to purchase silver to meet the enormous demand for rupees, and to reduce competition in buying silver, which would otherwise have raised its price still further, the import of silver into India on private account was prohibited in September, 1917. He bought nearly 32 crores of standard ounces of silver in five years.

But the world's demand was still very heavy and other sources of supply had to be tapped. The Government of the United States of America was approached with a

request to release a portion of the silver dollars held in their reserve. The request met with a ready response, and in April, 1918, the United States Congress passed the *Pittman Act,* which authorized the sale to other Governments of silver not exceeding 35 crores of dollars from the dollar reserve. Of this amount the Government of India acquired 20 crores of fine ounces, and this enabled them to tide over a very serious currency crisis.

(d) PROTECTION OF SILVER CURRENCY :- Attempts were also made to protect the currency against depletion by export or melting. Accordingly, from 29th June, 1917, the use of silver or gold coin for other than currency purposes was declared illegal ; and, from 3rd September, 1917, the export of silver coin or bullion from India was prohibited except under license.

(e) ECONOMY OF SILVER :—The use of silver was also economized by the issue of Rs. 2½ and Re. 1 notes and by the introduction of new two-anna, four-anna and eight-anna nickel coins.

(f) THE USE OF GOLD :—Efforts were also made to increase the stock of gold, and with this object an ordinance was issued on 29th June, 1917, requiring all gold imported into India to be sold to the Government. And the gold mohur, a 15-rupee coin of the same weight and fineness as the sovereign, was minted at the Bombay Mint as an emergency coin to supplement the stock of sovereigns available for issue during the crisis of 1918.

Gold was also sold to the extent of £4,000,000, and sovereigns and gold mohurs to the amount of £11,000,000 were issued for the financing of certain crops.

(g) INCREASE IN NOTE CIRCULATION :— One of the most prominent features of the currency policy of the Government before the outbreak of the War was

the encouragement of the use of notes by giving ample facilities for their encashment. This policy was continued as long as the supply of rupees was adequate. But, as we have seen, the absorption of rupees was abnormally high during the war and the silver balances had fallen very low. The unfavourable war news in March and April 1918 caused a run on the Bombay currency office and in other places. Inconvertibility appeared to be inevitable when the delivery of Pittman silver saved the situation. Facilities for the encashment of notes at district treasuries were withdrawn, and restrictions were placed on the transport of specie within the country. The result was a large substitution of notes for rupees in circulation, as shown in the following table :

| Date | Gross Note circulation in lakhs of rupees |
|---|---|
| 31st March 1914 ... | 66,12 |
| 30th March 1919 ... | 153,46 |
| 30th November 1919 | 179,67 |

Thus, the gross circulation of notes increased nearly *threefold*. But, at the same time, the difficulty of obtaining sufficient quantities of precious metals for coinage, and as a backing for the issue of additional notes, necessitated the *increase in the invested portion of the Paper Currency Reserve* which was raised from Rs. 14 crores to Rs. 120 crores by various ordinances. During certain periods there was in many parts of India a considerable *discount on notes* as high as 19 per cent., because as the rupee was comparatively scarce, it was preferred to notes. But, in the year 1919 the discount tended to disappear,

when it was seen that the notes were freely accepted in payment of Government dues.

(h) FINANCIAL MEASURES :—Various financial measures were also taken which affected the currency situation indirectly. Apart from measures taken to increase revenue and curtail expenditure, various *War Loans* were floated which yielded Rs. 130 crores, and short-term *Treasury Bills* were issued which brought in nearly Rs. 65 crores. These measures materially assisted towards meeting the heavy demand for remittance to India.

Such were the developments in the Indian exchange and currency system since 1914.

# CHAPTER VI.

## Post-War History.

- Period I. the year 1919.
  - Section (A) Rise in price of silver continued.
  - Section (B) Report of the Babington-Smith Committee.
- Period II. January 1920 to September 1920.
  - Consequences of the ratio 2s. a rupee.
- Period III. 1921 to 1925.
  - Condition of exchange.
- Period IV. 1926.
  - Report of the Hilton-Young Commission.

The history of Indian currency and exchange, after the War and coming down to the end of 1926, can, for the sake of clearness, be studied into four periods, as given in the above chart. Each period is so selected that it marks out the influence of an outstanding feature.

### PERIOD I—The year 1919.

### SECTION A.—Rise in the price of silver continued.

In the last chapter we have already drawn out the important facts in the Indian currency history during 1919. We need only summarize them here.

The important features were the following :—

(1) *The Balance of Trade was still highly in favour of India* in spite of the war being over, because although the huge demand for Indian commodities for war purposes was considerably reduced, a new demand arose in Europe and America for manufacturing peace-time goods. It became increasingly difficult to liquidate this favourable balance.

(2) We also saw how the price of silver steadily rose, till it reached 78*d*. per standard ounce on 17th December, 1919, and brought with it extraordinary difficulties in the currency system, the chief being endangering the convertibility of the note issue which was only averted by the Pittman silver.

(3) The influence of the Dollar-Sterling Exchange was also made clear. As sterling fell in terms of the dollar, the price of gold rose to the same extent, and the rate of exchange fluctuated.

## SECTION B.—Report of the Babington-Smith Committee.

All the difficulties consequent on the unprecedented rise in the price of silver, and specially the one of securing the convertibility of note issue, led to the appointment of a committee to consider the best means of overcoming them. Accordingly, in May, 1919, the Babington-Smith Committee was appointed. The Committee consisted of eleven members of which Mr. Dadiba, M. Dalal, the only Indian member, wrote a minority report, because he did not concur with the views of his colleagues on vital currency principles.

TERMS OF REFERENCE :—The report was submitted in December, 1919. The terms of reference were as follows :—

I. To examine the effect of the war on the Indian exchange and currency system and practice, and upon the position of the note issue, and to consider if any modifications were necessary.

II. And to make recommendations on them and generally as to the policy that should be pursued with a view to meeting the requirements of trade, to maintaining a satisfactory monetary circulation, and '*to ensuring a stable Gold Exchange Standard.*'

Thus, the last phrase of the reference 'to ensuring a stable Gold Exchange Standard,' *precluded the Committee from considering or recommending any other standard for Indian currency.*

CONCLUSIONS DRAWN FROM WAR HISTORY :—The conclusions which the Committee drew from the history of the Indian currency system during the war were the following :—

(1) The system built up since 1893 worked well, and was beneficial to India. It had supplied suitable media for internal circulation, provided means for the settlement of the balance of trade, secured stability between the rupee and sterling, and prevented the fall in the value of the rupee below 1*s*. 4*d*.

(2) "*But the system was not proof against a great rise in the value of silver.* In framing it this contingency had not been taken into account." Consequently, when the unexpected happened, it threw the currency system into extreme difficulties and dangers.

THE INHERENT WEAKNESS OF THE SYSTEM :—Particular stress is to be laid on this fact. It was the inherent weakness of the system evolved after 1893 that, while it made provision against a fall in the value of the rupee below 1*s*. 4*d*., *it* made no provision against *a rise in the value of the rupee above 1s. 4d. consequent on a rise in the price of silver. The rupee melting-point, in short, was not considered.*

## Recommendations of the Majority.

IMPORTANCE OF STABILITY OF EXCHANGE :—Before coming to the stabilization of the rupee the Majority examined in what respects exchange stability was important. "Our conclusion,"

they wrote, "is that, for the current operations of trade, *stability is an important facility rather than an essential condition.* There are many instances, including that of India herself before the closing of mints, which show *that trade has flourished, and can flourish, with a fluctuating exchange.* The conditions are somewhat more speculative, but the difficulties which may arise are not insuperable, and the banks are not slow to supply machinery which enables the merchant to cover his risks."

And yet they observed that stability of the rupee was of great importance for India, and that the rupee should be stabilized at as early a date as possible. The reasons given were the following :—

(1) that stability is a necessary condition for the free investment of external capital in India, as well as for the protection of capital already invested ;

(2) that a stable exchange facilitates the free movement of funds to and from India, thus assisting commercial finance and tending to avert temporary stringencies ;

(3) that whatever the evils and inconveniences of instability may be, they are increased if the movements are brought about *not by the automatic action of economic causes, but by administrative acts.* The commercial community are prepared to deal with fluctuations of exchange resulting from economic causes ; but they feel that "if official action intervenes to interpret the play of natural forces and to give effect to them, an element of uncertainty is introduced which is beyond their reckoning." In short, an automatic system, which did not depend upon official action, was greatly to be preferred ;

(4) that a stable level of exchange gives the most healthy condition for production and trade.

### I. The Ratio should be 2s. Gold.

The Majority recommended that the rupee should *be fixed at 2s. gold.* It is important to know the grounds on which they based their decision.

(A) THE PRICE OF SILVER :—The most important factor they considered was the price of silver. From the evidence which they collected they believed that the *price of silver would remain high for some years,* as the world's demand for silver was likely to continue on a large scale. Accordingly, they estimated that, keeping a safe margin, if the price of silver were 62.9*d.* (gold) per standard ounce (137.8 cents per fine ounce in America), then the rupee's bullion price would be equal to 1*s.* 11.36*d.* (gold). If we add to this the cost of making the rupee, the total would be 2*s. approximately*.

The Majority believed that, if the exchange value of the rupee were fixed at a figure not lower than this, there were reasons to believe that the rupee could be established as a token coin.

### (B) Effects of High Exchange.

The Majority also considered the more general economic effects of a high exchange.

(1) EFFECT ON THE LEVEL OF PRICES IN INDIA :—They concluded that, *but for the high rate of exchange, the level of prices in India would have risen still further,* and affected the population adversely. They admitted that the exceptional conditions, under which trade was conducted during the war, made it impossible to measure precisely the extent to which the high exchange influenced rise in prices. There were, for instance, factors such as Government control over the movement and prices of

food grains in India and restrictions on finance and freight, which also prevented prices rising.

But they stated that, in accordance with the accepted economic theory, Indian prices would, but for the rise in exchange, have been still further enhanced. This theory was explained as follows :—

(i) Taking the *case of imported commodities*, we would find that the sterling price at which the merchant could lay down goods in India would be determined by the cost of production, transport, and other charges. If the exchange value of the rupee rose, this sterling cost would be represented by a smaller number of rupees, and the goods could be sold at a lower rupee price.

(ii) Again, taking the case of exports such as wheat, (whose price outside India was determined by world-wide conditions of production and consumption), we would find that the sterling price, which could be obtained for a given quantity of it, would, if exchange rose, be represented by a smaller number of rupees, and the price which the grower would receive must necessarily be lower than before.

This would mean a heavy loss to the agriculturist. But the Majority considered that, as the world's shortage of food-stuffs and raw materials was likely to continue for some time, the demand for Indian produce would be ensured. Besides, the general rise of prices in countries importing from India should enable the Indian producer to obtain a satisfactory rupee price for his produce in spite of the high exchange.

But these considerations would not apply to products which are grown almost entirely for *internal consumption*, *e. g.*, food grains, such as, jawar and bajra. Nor would they be applicable in the case of jute, which enjoys a

practical monopoly. It was not, therefore, desirable to restore a low level of exchange, for it would tend to augment prices generally and to aggravate the danger of social and economic discontent.

(2) EFFECT ON INDIAN TRADE :—A high exchange stimulates imports and checks exports, but they stated that these effects were transitory, and that they were no longer operative when wages and other elements of cost had adjusted themselves to the new level of exchange.

Besides, Indian trade was prosperous and was likely to maintain this prosperity for some years. The world shortage of raw materials and food-stuffs was likely to ensure a continued demand for Indian produce during the period necessary for complete adjustment, and this was likely to give him a satisfactory rupee price, because of the rise in general prices in countries importing from India.

Moreover, high exchange would bring to the producer various advantages. It would tend to keep down the cost of imported stores and machinery as measured in rupees; and if it would exercise a check on the rise of prices, it would reduce the cost of living in India and consequently put a check on the rise of wages.

Thus, they concluded that Indian trade was not likely to suffer any permanent injury from the fixing of exchange at a high level.

But the Majority gave *one qualification* to this statement. *It was that prices should remain at a high level for a considerable time,* and that any return to lower level would be gradual. But if, on the contrary, a rapid fall in world prices were to take place, the cost of production in India would fail to adjust itself, with equal rapidity, to

the lower level of prices, Indian exports would suffer, and the rate of exchange could not be maintained.

(3) EFFECT ON INDIAN INDUSTRIAL DEVELOPMENT :—A high rate of exchange would temporarily stimulate competitive imports into India, especially from countries where the cost of production was low. But even during the period which may elapse before the adjustment of prices and other conditions to the new level was complete, they considered that India was not likely to be adversely affected because the cost of production in the exporting countries of Europe and America had greatly increased. Moreover, a high exchange would tend to bring to India the advantage of a low cost for wages and raw-materials and for imported articles that enter into cost. Therefore, the development of Indian industry would not be seriously hampered by a high rate of exchange.

(4) EFFECT ON HOME CHARGES :—They also pointed out an incidental advantage in fixing the exchange at a high level. At 1*s.* 4*d.* exchange to remit £25,000,000 a year, the rupee cost would be 37½ crores; but, if the same were to be remitted at 2*s.* exchange, the rupee cost would be 25 crores, *i. e.* a saving of Rs. 12½ crores.

On the other hand, there would be a loss involved in the revaluation in rupees of the sterling investment and the gold with the Secretary of State. This loss would amount to 38.4 crores.

But, if the whole of the amount saved in respect of remitting the Home Charges were utilised for the purpose of meeting this loss, it could be recouped in 3 years. And thereafter it would enable the Indian Treasury to do without additional taxation of Rs. 12½ crores every year.

**II. The Rupee should be linked to Gold and not to Sterling.**

The second main recommendation of the Majority was with regard to the manner in which the exchange should be fixed. Should it be linked to sterling (its pre-war relation) or to gold? They recommended that the rupee should be linked to gold and not to sterling.

THE REASONS GIVEN :—(1) Before the war the convertibility of sterling (paper) into gold in England was complete. Gold coins were in circulation and sterling and Bank Notes could be exchanged without difficulty with gold. It was, therefore, unnecessary, in considering the problems of Indian exchange, to make any distinction between the two. But since the War the situation had been different. The gold coin was no longer in circulation and had appreciated in terms of sterling. The sovereign (gold) was at a premium of 28 per cent. and £1 sterling (paper) was at a discount of 22 per cent. on 17th December, 1919. Under these circumstances, and specially because sterling was depreciating, it would be unwise to fix the rupee in relation to sterling. Until sterling became again equivalent to gold, *the rupee-sterling exchange would fluctuate, in the same manner as the dollar-sterling exchange,* and far from making the rupee stable, it would make it fluctuating.

(2) If the rupee were linked to sterling, the exchange value of the rupee to be fixed in sterling would have to be a *higher one* than in gold, because sterling had depreciated very much. This might not be regarded as an immediate disadvantage. But in the future, if sterling were to recover its value and become again equivalent to gold, the sterling value for the rupee might *be found to be* high (since the value would have increased in relation to gold). And if it were to be reduced, the *reduction*

*would be too heavy* and would be injurious to commerce and trade. If, on the other hand, the value were fixed in relation to gold, it could be fixed safely at a lower figure.

(3) If the relation of rupee to sterling were fixed, while sterling varied in relation to gold, the rupee would vary with gold. But if the rupee and the sovereign were both to remain unlimited legal tender in India, as it was thought essential, it was necessary that *their relation should be fixed,* because two coins cannot remain in circulation as unlimited legal tender and at the same time stand in a variable relation to one another.

(4) The Majority also considered it very desirable to permit the free export and import of gold bullion and coin and to issue gold coin in India for an equal weight of gold bullion subject to an appropriate coinage charge. This could be facilitated by linking the rupee to gold.

### Summary of Recommendations.

We now summarize the main conclusions and recommendations of the Majority.

(1) It was desirable to *restore stability to the rupee* and to *re-establish the automatic working of the Indian currency system* (The Gold Exchange Standard).

(2) The exchange value of the rupee should be fixed in terms of *gold* rather than in sterling.

(3) The stable relation to be established between the rupee and gold should be at *the rate of Rs. 10 to one sovereign,* or, in other words, at the rate of one rupee for 11.30016 grains of fine gold, both for foreign exchange and for internal circulation.

(4) The obligation of the Government to give rupees for sovereigns should be withdrawn.

(5) The import and export of gold to and from India should be free from Government control.

(6) The prohibition on the import of silver should be removed, but that on the export of silver should be retained for the present with a view to protecting silver from depletion by export.

Other recommendations were with regard to the constitution of the Gold Standard Reserve and the Paper Currency Reserve and the sale of the Council Bills and Reverse Councils.

(*a*) As regards the *Gold Standard Reserve* :—

(1) that no limit can yet be fixed to its amount ;

(2) that it should contain a considerable proportion of gold ;

(3) that the remainder should be kept in securities issued by Governments within the British Empire (other than the Government of India) and having a fixed date of maturity of not more than 12 months ;

(4) that a proportion of gold, not exceeding one half, should be held in India.

(*b*) As regards *Council Bills and Reverse Councils* :—

(1) that Council Drafts, although sold for providing for Home Charges could also be sold by the Secretary of State in excess of his immediate requirements, *when a trade demand for them exists,* by competitive tender ;

(2) that during the periods of exchange weakness the Government of India should be authorized to announce, without previous reference to the Secre-

tary of State, their readiness to sell weekly a stated amount of Reverse Councils.

The recommendations with regard to the Paper Currency Reserve will be dealt with in the Chapter on Indian Paper Currency.

**Conclusions of the Minority:**

(Mr. Dadiba Merwanji Dalal.)

Mr. Dalal entirely dissociated himself from the recommendations of his colleagues. He, in his Minority report, answered in details the various arguments of his colleagues. We shall summarize here those of his views which have an important bearing on the future history of Indian currency.

(a) SOVEREIGN — THE MONEY STANDARD :—He took the view that the legally established money standard was the *Sovereign with rupees definitely related to the sovereign at the rate of 15:1.* "In contradistinction to this legally established standard," he stated, "the Gold Exchange Standard has no legal validity. It has not been clearly and explicitly defined. The authorities who conduct it *exercise the widest discretion* in its regulation, but hitherto have been careful to respect the legally constituted ratio between the rupee and the sovereign. The policy pursued is one which has persistently ignored the essential safeguards of a gold standard, and *particularly the safeguard, of limiting the issue of token coins.* The *endless issue of token coins, much in excess of what is needed for internal exchange purposes,* amounts to a form of taxation on the money of the public. It is this circumstance that is to a large extent responsible for the extraordinary demands for gold and sovereigns in India. It virtually

compels the Indian people to seek full value for the token money, with which they have been over-supplied for ordinary currency purposes, and is thus largely responsible for the hoarding of gold of which so much is heard.... It has by mere executive action changed the legally established gold standard into Gold Exchange Standard making the maintenance of exchange the object to be attained in place of the provision of gold money with a limited token money.''

Moreover, the system broke down at a time when India enjoyed a large measure of prosperity.

(b) RISE IN PRICE OF SILVER WAS ENTIRELY ARTIFICIAL :—He was unable to fall in with the idea that the rise in price of silver afforded solid grounds for raising the rate of exchange. "I contend that the price of silver has been artificially forced to its high level.'' The reasons given were the following :—

(a) *The rise in price of silver could have been prevented by removing the embargo on exports of silver from India after the war ended,* and it was after the war that the great rise took place. India could easily have spared silver for export ; such exports would have been profitable to her, and they would have prevented the great rise in price. The price 78*d.* per standard ounce was made possible only by the prohibition of exports of silver from India and by the raising of the rate of exchange, which had the effect of lowering the rupee value of all silver held there and making exports unprofitable.

It was because India was made a potential buyer instead of a seller that the silver markets were inflamed and the price was raised.

(b) Coupled with this embargo on exports of silver

from India was another fact. The Pittman Act Compelled the Government of the United States to replace all the silver dollars which she had given to other countries, and until that was done, to go on buying American silver at 1 dollar per fine ounce. As this process of replacement was likely to continue for some years (as the silver dollars withdrawn under the Act represented between twice and three times the normal American production), the production of American silver was assured of a market. Under the circumstances any probability of fresh demands for silver from India and China was expected to raise the price of silver. Had India been allowed to sell silver, its rise in price would have been prevented. In short, the high price of silver was to be regarded as entirely artificial.

(c) THE STANDARD RATIO 1*s*. 4*d*. A RUPEE SHOULD NOT BE ALTERED :—He was of opinion that there was no justification whatsoever for raising the ratio because—

(a) the high world price of silver was wholly artificial and thoroughly inflated and could have been prevented by removing the embargo on the export of silver from India.

Even if the embargo were not removed, there was no occasion to raise the ratio. India did not require additional supplies of rupees. She could carry on for many years without any new silver coinage.

(i) The only alteration required would have been to *stop the coinage of rupees, and that would have occurred automatically by reason of the loss coinage would involve.*

(ii) At the same time, *the sale of rupee bills in London by Government in excess of their own Treasury requirements should have been stopped,* and the balance of trade

left to be adjusted by other means than silver. Rather than give up the sale of rupee bills (and thus remove the necessity of further silver coinage in India), the Government unnecessarily raised the rate of exchange.

(b) There was no advantage in making the rate of exchange follow the price of silver. One of the advantages claimed in former years for issuing rupees instead of sovereigns was that it was economical. The rise in price of silver took away the advantage. "If silver has to be bought at present prices (78*d.*) and coined into rupees at the present rate of exchange, there is no economy of any consequence in using silver instead of gold."

The world-wide embargo on the exports of gold was removed and the United States of America became a free market for gold on 9th June, 1919, and the gold production of South Africa became available in London on 18th July, 1919; there was, therefore, absolutely no justification for raising the rate of exchange.

(c) "Raising the rate would have disastrous consequences to India and to the people of India. They must seriously disturb the existing relation between creditor and debtor. They will cause dislocation and set-back to several Indian industries and vast continuous losses on the exporters of Indian produce. There is a danger of India's balance of trade turning against her and so checking her prosperity. And it should be remembered that between 100 and 200 millions of people live on the brink of starvation, and a great permanent change in the rate of exchange must ultimately bring intense distress to millions of the helpless masses." It would also cause a colossal loss to the Indian public who held about 50,000,000 sovereigns, and enormous loss to India by the revaluation of the sterling securities and gold held in the reserves.

## PERIOD II—The year 1920.

### Consequences of the 2s. rupee ratio.

**1920**

- up to June — Effects of the fall in London—New York Exchange
- from June to September — Effects of adverse balance of trade
- from September to December — Effects of withdrawal of support to exchange

The recommendations of the Babington-Smith Committee were accepted by the Secretary of State, and various notifications were issued on 2nd February, 1920, along with the publication of the report.

THE ACTION TAKEN ON THE REPORT :—
The notifications were as follows :—

(1) The acquisition rate for gold imported under license into India would be fixed at Rs. 10 per sovereign or one rupee for 11.30016 grains of fine gold ;

(2) Council Drafts and Telegraphic Transfers would be offered for sale weekly by competitive tenders. with no fixed minimum rate ; and that Telegraphic Transfers would be offered in India when required at a rate based on the sterling equivalent. of the price of 11.30016 grains of fine gold as measured by the prevailing sterling-dollar exchange, minus a reduction for the cost of remitting gold ;

(3) the obligation on the part of the Government to give rupees in exchange for sovereign and half-sovereign at the rate of Rs. 10 and Rs. 5 respectively was cancelled ;

(4) prohibition on the import of silver and the duty on its imports were abolished ;

(5) the prohibition of melting of gold and silver coins was removed.

INFLUENCE OF THE DOLLAR-STERLING EXCHANGE :—During the War, as we have seen, the British Government, in order to control the price of silver, had "pegged" the dollar-sterling exchange at $4.76\frac{7}{10}$ dollars equal to 1£ sterling. The control on the exchange was removed in March, 1919, and the free market for gold was established.

The notification that bills would be sold in India subject to *the price of gold being regulated by the sterling-dollar exchange* had a great influence on Indian exchange at this time. It may at first be asked, why was this complication introduced? It was because the United States of America was the country which was the real source of world's supply for gold and silver. Besides, its standard coin was at *par* with gold, being a creditor country to England and other countries, and it had a free market for gold. As England had to make payments of enormous sums to the United States of America for the loans borrowed, the *price of gold in London had to take account of the sterling-dollar exchange.* If sterling fell in relation to the dollar owing to adverse circumstances, more sterling would have to be paid for buying a given quantity of gold in America than before. The sterling price of gold in London would, therefore, rise and the gold sovereign would fetch more shillings than before. Therefore, if one sovereign is equal to Rs. 10, each rupee would buy more shillings than before, *i. e.*, the rupee-sterling exchange would rise accordingly. *If the sterling-dollar exchange fell, the rupee-sterling exchange would rise.*

**The Sale of Reverse Councils.**

Even when the notification was issued with regard to the two-shilling ratio, the market price of silver was higher than 2 shilling gold. This was an opportunity for a financier to wait but India Office would not do so. The Government announced its intention to maintain the rate by the sale of Reverse Councils in London at the market rate. This announcement resulted in an unprecedented demand for them.

(i) EXPORTERS DISCOUNT THE BILLS :—On 2nd February the American cross-rate fell to 3.65, and the rupee-sterling exchange rose accordingly. But the Indian exporters, fearing that further fall in cross-rate would occur, thought it wise to sell off their bills to prevent further loss to themselves. So heavy was the demand for discounting the Bills that the exchange rose to 2*s.* 8½*d.* within three days of the announcement of the 2*s.* ratio, and at one time it soared as high as 2*s.* 11*d.* But within a few days a further fall took place in the sterling-dollar exchange, and under the same influence the exchange jumped up to 2*s.* 10½*d. on February 11th.* But after this date the tide of the exporters anxious to sell the bills ebbed.

(ii) RUSH FOR REMITTANCES TO ENGLAND :—As the rate of exchange steadily rose, there arose a keen demand for remittances to England, as it was very cheap to do so. The demand came from genuine Indian importers for Reverse Councils. Foreign businessmen and firms in India found this the most profitable time for remitting their profits to England. The huge War profits also led to a boom in the formation of Joint Stock Companies. And those companies, which had placed orders in England for machi-

nery, now remitted in advance the payment for them. Lastly, there were those speculators who remitted their money to England in the hope of bringing it back after exchange fell sufficiently thereby making large profits.

So great was the demand for Reverse Councils and such was the speculation indulged in them, that there arose *a difference between the Reverse Council rate and the market rate and the money market was completely disorganized.* The market rate began to fall, but the Reverse Council rate remained high for some time, and this in return led to a gigantic speculation.

(c) ADVERSE BALANCE OF TRADE; JUNE, 1920:—But the most important cause, which aggravated the demand for the Reverse Councils and kept the market rate of exchange lower than the rate for them, was the adverse balance of trade. From January to June 1920 the favourable trade balance was diminishing little by little. The value of the imports was increasing considerably, whereas the value of the exports was diminishing. And in June the balance of trade became definitely *unfavourable* to India, and there was an excess of imports over exports to the extent of Rs. 2.83 lakhs.

The reasons for this were not far to seek. The Indian export trade was already weak. The great consuming markets were already glutted with Indian produce, nor had some European countries the buying power to purchase our commodities sufficiently. The rains of 1920 had failed and the embargo on food stuffs could not be removed. Besides, the high exchange gave a powerful stimulus to import trade; and immense quantities of manufactured goods, specially textiles, began to come forward. At this time Japan was the largest buyer of Indian cotton, but a commercial crisis in that country not

merely stopped Japanese merchants from buying it, but they resold cotton in the Indian market.

This adverse balance continued throughout the rest of the year and made the stabilization of the exchange at 2*s*. gold an impossible problem.

The result of the adverse balance of trade was a *heavy fall in exchange*. On 1st June it stood at 2*s*. $1\frac{1}{4}$*d*., and it began to fall until it reached 1*s*. $8\frac{1}{4}$*d*. by the end of the month ; then there was some recovery after which it fluctuated round 1*s*. 10*d*. up to September.

ALL ATTEMPTS TO RAISE EXCHANGE FAIL :—Strenuous efforts were made by the Government to strengthen and to prevent the exchange from falling.

(1) They sold £2 millions of Reverse Councils a week, then £5 millions, and ultimately dropped down to a steady 1 million.[1] The lowest tender offered was of Rs. 50 lakhs, but this aggravated the evil, and "exchange became a tool of wealthy speculators and exchange banks". And the wider became the margin of difference between the market rate of exchange and the Reverse Council rate, the more intense became the speculation.

(2) Being unsuccessful in holding the rate at 2*s*. gold (on the basis of the sterling-dollar exchange) the Government tried to maintain it at 2*s*. *sterling*, leaving the gap between sterling and gold to be closed when the dollar-sterling became par. Immediate Telegraphic Transfers were sold from this date at 1*s*. $11\frac{19}{32}$*d*.—this figure represented the rate which would ultimately hold when sterling once more returned to parity with gold.

This attempt also failed, because the natural forces of trade were too strong for any artificial action.

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1 The Indian Year Book, 1922.

(3) In order also to maintain the exchange at 2*s.* gold, the Government continued to sell considerable quantities of gold in India every fortnight. They sold 53 millions of gold, but this did not affect the premium on gold. The object was to reduce the price of gold relatively to the rupee. But attempts to do so failed, and gold at certain times actually left India for liquidating the adverse balance.

(4) The Government of India at this period tried their utmost to *contract currency* with a view to bringing up the exchange value of the rupee. When the Reverse Councils were bought by the public, they were paid for in the currency notes and silver rupees. *These currency notes were withdrawn from circulation and cancelled.* The sales of the Reverse Councils were met by the sale of the securities in the Paper Currency Reserve, because the Treasury Balance held by the Secretary of State proved insufficient for this purpose. Hence to the extent that the Currency notes were cancelled, *the Paper Currency Reserve was reduced.* Thus, the gross circulation which stood over 183 crores by the middle of January, 1920, was steadily withdrawn till it was reduced to 158 crores by the middle of September.

WITHDRAWAL OF SUPPORT; SEPTEMBER, 1920 :—All attempts having failed to strengthen the exchange, the Government suspended entirely the sales of the Reverse Councils at the end of September. "All support was withdrawn, therefore, from exchange which was left to the tender mercies of supply and demand."[1] As soon as the Government withdrew their support, the exchange at once fell from 1*s.* 10*d.* to 1*s.* 8*d.*, and then continued to fall till it reached nearly 1*s.* 5*d.* in December.

[1] Jevons: *Money, Banking and Exchange in India.*

THE SACRIFICE INVOLVED :—The measures taken to bring up the exchange to 2*s*. had disastrous effects on the Indian exchequer and on Indian trade.

(a) In the first place, the Reverse Councils were paid in London out of the sterling securities and Treasury Bills belonging to the Paper Currency Reserve. These securities and bills were bought at the rate of Rs. 15=£1. But they were sold to pay for the Reverse Bills at the rate of £1 = Rs. 10 and sometimes Rs. 8 and even Rs. 7. *The difference was the heavy loss borne by the Indian Treasury.* The total amount of the Reverse Bills sold was £55,382,000. This meant a loss of more than Rs. 40 crores to the Indian exchequer, and that too at a time of adverse trade balance.

(b) The effects on Indian business were acute. "Exporters found themselves loaded with produce for which there was no foreign demand ; importers found themselves loaded with imported goods, bought in the expectation of the continuance of a high rate of exchange, delivered when it had fallen one and four pence from the highest point reached. Immense losses were incurred by importers, who, when the year closed, were struggling to liquidate their stocks in almost desperate conditions."[1]

(c) Besides, deflation of currency brought the importers into serious difficulties. In the first place, it made the money market tight and raised the bank rate of interest on loanable money ; and in the second place, it tended to bring down the general level of prices. In both ways, therefore, businessmen were hard hit, and were compelled to sell off their stocks at ruinous prices. Thus, in the words of Sir Stanley Reed, "a policy which was avowedly adopted to secure fixity of exchange produced the greatest

[1] The Indian Year Book, 1922.

fluctuations in the exchanges of a solvent country and widespread disturbance of trade, heavy losses to the Government, and brought hundreds of big traders to the verge of bankruptcy."

OTHER MEASURES IN 1920 :—Even during this period of confusion the Government of India passed legislation to give effect to the recommendations of the Babington-Smith Committee.

(*a*) On 21st June, 1920, an Ordinance was issued by which the sovereign and the half-sovereign ceased to be legal tender in India, but a notice was given to the effect that, if they were tendered at the Government Offices within a period of 21 days, the Government would accept them at the rate of Rs. 15 and Rs. 7½ respectively. Sovereigns amounting to £2½ millions were thus tendered by the public. Restrictions on the import of gold bullion and foreign gold coins were withdrawn after this period was over.

(*b*) But in September, 1920, the Indian Coinage Amendment Act was passed which made the sovereign and the half-sovereign legal tender in India for Rs. 10 and Rs. 5 respectively.

(*c*) Then again, the Paper Currency Amendment Act was passed in October, 1920, which was meant to put into action the recommendations of the Committee with regard to Paper Currency. We shall deal with it in the Chapter on Paper Currency.

## PERIOD III—1921-1925.

TRADE CONDITION DURING THE YEAR :- During the year 1921-1922, the serious depression in trade continued. "The year 1921-22 will rank as a classical example of what trade-cycle economists characterise as the readjustment period."[1] The period of readjustment, after the boom that followed the War, began with 1921, when the period of liquidation set in. Europe was still unable to buy Indian commodities in sufficient quantities and

[1] The Indian Year Book, 1923.

the balance of trade was *against* India. The chief factors responsible for this were the falling tendency of prices and the instability of exchange.

But in 1922 the stagnation in exports disappeared and the balance of trade became favourable to India. The rains were ample and good harvests were reaped in almost all parts of the country and the exportable surpluses of food stuffs and raw materials were considerable. But the real factor which changed the tide was the purchasing power of European countries, which increased after the notable improvements in various industries. This prosperity in India was reflected in the import of treasures to the extent of Rs. 59 crores as against Rs. 13 crores, which was the total amount of the two preceding years.

The improvement in India's trade and commerce was maintained during the following years, and there was steady progress towards more stable economic conditions. This improvement was as follows :—

| Year | Exports and Imports of Merchandise on private account (in *crores* of rupees) | | | Total Net Imports of treasure on private account (in *crores* of rupees) |
|---|---|---|---|---|
| | Exports | Imports | Net exports | |
| 1920 | 258 | 335 | -77 | 1 |
| 1921 | 245 | 266 | -21 | 12 |
| 1922 | 314 | 224 | 90 | 59 |
| 1923 | 362 | 217 | 145 | 47 |
| 1924 | 398 | 243 | 155 | 94 |
| 1925 | 375 | 226 | 149 | 62 |

EXCHANGE DURING THE PERIOD :—We saw how, on the 28th September, 1920, the Government abandoned the attempt to maintain the exchange at 2s. sterling. Left alone, the rupee began to find its own natural level, subject to the laws of demand and supply (see table at the end of the Period). The price of silver was at this time falling rapidly. And under the combined influence of adverse balance of trade and fall in price of silver, the exchange fell steadily until in December, 1921, it reached 1s. $3\frac{7}{8}$ *d.* sterling or 1s. $1\frac{5}{32}$ *d.* gold. The Government of India were unable to contract currency sufficiently to bring up the exchange.

ATTEMPTS TO BRING EXCHANGE UP TO 1s. 4*d.* STERLING :—But during 1922 the balance of trade was favourable to India and the Government took various measures within their power to prevent the rupee from falling below 1s. 4*d.* sterling.

(1) In the first place, increase in taxation and retrenchment were resorted to in order to balance the Budget.

(2) At the same time the Secretary of State stopped the sale of Council Drafts in London, and thereby prevented the additions of rupees which would have been made to the circulation in India. He met his requirements by borrowings in London and by receiving from the Imperial Government some part of the amount which it owed to the Government of India for expenditure incurred by the latter on its behalf.

(3) Then, the currency was also deflated throughout the year.[1] The methods employed were the *sale of Indian*

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[1] It would interest the reader to know the various ways of deflating or contracting currency given by Professor H. S. Jevons in his book *The Future of Exchange and Indian Currency* (pages 190-193). He gives 3 principal ways of contraction: (1) By the sale of reverse councils and cancellation of currency notes equivalent to the price paid for them. (2) By realization of the

*Securities in the Reserve and the corresponding cancellation of notes that came in, and applying* the interest on securities in the reserve to the deflation of note issue.

RUPEE REACHES 1*s*. 4*d*. STERLING (JANUARY, 1923) :—By the combined effect of these measures the rupee reached 1*s*. 4*d*. sterling in January, 1923, its pre-war level. And, since the balance of trade was also favourable to India, there was a demand from some quarters that the fictitious ratio of two-shillings may be abolished and the pre-war ratio of 1*s*. 4*d*. sterling established. But the Government considered such a step hazardous, as it was not possible to forecast accurately the future of sterling.[1]

DEFLATION OF CURRENCY AND STRINGENCY IN MONEY MARKET :—During the year 1923, stringency of money was generally felt in the Indian money market and the Government had to take power to issue *emergency currency* to the extent of Rs. 12 crores *against commercial bills* endorsed by the Imperial Bank. Besides, they had to purchase sterling in *India* and issue fresh currency against it. "To do something to mitigate stringency in the money market, we have remitted no less than 12 crores

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metallic portion of the reserve. The operation is this. A particular number of silver coins should be melted down or sold and the loss arising to be made up from the sale of gold in the Paper Currency Reserve which would bring a profit. (3) By the sale of rupee securities in the reserve and notes to be cancelled off to the value of the price realized by the sale of the securities. Or a loan may be issued and the proceeds may be used for the redemption of the rupee securities and cancellation of notes.

Each of these methods was pursued by the Government of India as occasion required.

[1] "You know very well the difficulties which England is facing at the present moment. On the one hand, the payment of the American debt involves a direct burden on the exchange, of which the full effects have yet, perhaps, to be appreciated on both sides of the Atlantic. On the other hand, internal resources are being strained by yet another winter of unemployment." Sir Basil Blackett, in his speech before the Associated Chambers of Commerce, on 5th December, 1923.

(sterling) to London against issues of Paper Currency in India."[1] Thus, in all Rs. 24 crores of emergency paper currency was issued. But even these measures were not adequate enough to satisfy the needs of trade. This was proved by the fact that the rate of the Imperial Bank of India stood at 9 per cent. from February to April, 1924.

All these factors would lead one to conclude that the *expansion of currency* to meet trade requirements was *inadequate.* In other words, there *was relative contraction of currency or deflation* of currency. Thus, suppose at a given time trade requires an addition of Rs. 30 crores to circulation, but Rs. 24 crores only are issued, there would be a deflation to the amount of Rs. 6 crores or a relative contraction to that extent. Avoiding the necessary expansion of currency is equivalent to a contraction of currency in its effects.[2]

RUPEE REACHES 1*s.* 4*d.* GOLD (OR 1*s.* 6*d.* STERLING) IN OCTOBER 1924:—The rupee rose to 1*s.* 6*d.* sterling or 1*s.* 4*d.* gold in October, 1924. The action taken by the Government of India since this date was *directed towards preventing the rise of the rupee above 1s. 6d.* sterling. The reason for taking action at this point has been given by the Hon. Mr. McWatters, Finance Secretary to the Government of India. "The position then arose that Government had before them a strong representation from the Bengal Chamber of Commerce which pointed out that the commercial community were much exercised

[1] Budget speech of the Finance Member on 29th February, 1924.

[2] In his answer to Question 7, put by the Chairman of the Royal Commission on Indian Currency and Finance, 1926, Sir Basil Blackett said: "The policy up till August, 1923, was to encourage the natural tendency to a rise by effecting some actual contraction of the currency which had been very considerably redundant after the War. After August, 1923, it was to check the tendency to further rise by making some additions to the Currency."

as to the possible results of the *next busy season*. They saw *no chance of avoiding extreme fluctuations in exchange* unless some definite action was taken by Government, and the Government at that time came to the view that any substantial rise in exchange above 1*s*. 6*d*.—with possible fluctuations up and down—might be extremely harmful.''[1]

STERLING REACHES GOLD PARITY; APRIL, 1925:—In April, 1925, sterling reached gold parity, *i. e.*, 1*s*. 6*d*. sterling became equivalent to 1*s*. 6*d*. gold. And the policy of the Government since that date may be translated into *preventing the rise of the rupee above 1s. 6d. gold*. Since this date, the exchange value *above* the rupee remained practically steady at this figure (see table on page 139). Whether the exchange was kept at 1*s*. 6*d*., during the coming year, by being prevented from falling below that figure by Government action, or natural forces kept it at that point, we shall see in the Report of the Royal Commission on Currency and Finance, 1926. In short, we shall know whether it was a '*de facto*' ratio or a '*fait accompli*'.

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[1] In his answer to Q. 693 before the Royal Commission on Indian Currency and Finance, 1926.

**Rate of exchange from Calcutta on London on the 1st of the month.**

| Year | Sterling | | Gold | | |
|---|---|---|---|---|---|
| | *s.* | *d.* | *s.* | *d.* | |
| 1920— | | | | | |
| January ... | 2 | $3\frac{7}{8}$ | 1 | 10 | |
| December... | 1 | $6\frac{3}{8}$ | 1 | $1\frac{3}{16}$ | |
| 1921— | | | | | |
| January ... | 1 | $5\frac{1}{4}$ | 1 | $0\frac{15}{32}$ | |
| July ... ... | 1 | $3\frac{5}{6}$ | 0 | $11\frac{23}{32}$ | |
| December... | 1 | $3\frac{7}{8}$ | 1 | $1\frac{5}{32}$ | |
| 1922— | | | | | |
| January ... | 1 | $3\frac{15}{16}$ | 1 | $1\frac{25}{32}$ | |
| December... | 1 | $3\frac{31}{32}$ | 1 | $2\frac{27}{32}$ | |
| 1923— | | | | | |
| January ... | 1 | $4\frac{1}{32}$ | 1 | $3\frac{9}{32}$ | *Rupee reaches pre-war level.* |
| December... | 1 | $5\frac{7}{32}$ | 1 | $3\frac{3}{8}$ | |
| 1924— | | | | | |
| January ... | 1 | $5\frac{3}{32}$ | 1 | $3\frac{1}{16}$ | |
| October ... | 1 | $5\frac{23}{32}$ | 1 | $4\frac{1}{4}$ | *Rupee reaches 1 s. 4d. gold.* |
| December... | 1 | $6\frac{1}{32}$ | 1 | $5\frac{3}{16}$ | |
| 1925— | | | | | |
| January ... | 1 | $6\frac{1}{16}$ | 1 | $5\frac{21}{32}$ | |
| April ... ... | 1 | $5\frac{27}{32}$ | 1 | $5\frac{17}{32}$ | *Sterling reaches* gold parity. |
| December... | 1 | $6\frac{5}{32}$ | Nearly the same. | | |
| 1926— | | | | | |
| January ... | 1 | $6\frac{5}{32}$ | Do. | | |
| April ... ... | 1 | $5\frac{7}{8}$ | Do. | | |
| December... | 1 | $5\frac{3}{4}$ | Do. | | |

## PERIOD IV—Report of The Hilton-Young Commission, 1926.

A Royal Commission on Indian Currency and Finance was appointed under the Chairmanship of Commander Edward Hilton-Young. Of the eleven members of the Commission, *Sir Purushotamdas Thakurdas,* a distinguished Bombay merchant and Financier, wrote a minute of dissent.

TERMS OF REFERENCE :—The terms of reference to the Commission were—

(*a*) to examine and report on the Indian exchange and currency system and practice already existing; and

(*b*) to consider whether any modifications were desirable in the interests of India; and

(*c*) to make recommendations.

### (A) The Weaknesses of the existing system.

They analysed the existing state of affairs both in its economic aspect, which is that of the standard of currency, and in its administrative aspect, which is that of the authority to control the currency.

(1) NO AUTOMATIC WORKING OF THE STANDARD :—*The first great weakness they pointed out was that "the automatic working of the exchange standard is not adequately provided for in India and never has been so."*

They gave the following reasons for this :—

(a) that there was no *statutory obligation* to preserve the stability of the gold value of the rupee. This stability was at present based on nothing substantial than the policy of the Government, and that policy could be found defined in no notification or undertaking by the Government. It had to be *implied* from the acts regarding currency, but these were subject to no statutory regulation or control. They bought and sold sterling whenever they liked ;

(b) that the two *reserves,* which were kept to maintain the value of token currency, were the real pivots of our currency system. (The Paper Currency and the Gold Standard Reserves.) These reserves were subject to permanent constitutions. Thus, the permanent constitution of the Paper Currency Reserve provided for a metallic holding of gold and silver of not less than 50 per cent. of the notes issued, but these permanent provisions *had not been operative,* and during that time, the reserve was *governed by transitory provisions* which were likely to *disturb the proportion between the Paper Currency issued and the reserve kept to back it ;*

(c) *that the interest on investments* in the two reserves had been up to then *credited to the Government* revenue, particularly after April, 1923, and not for strengthening the reserves as the Acts require.

As regards the objects and functions of the reserves, they pointed out the following mistakes :—

(d) that *the objects of the two reserves were not clearly demarcated* and therefore confusion arose when the reserves performed their functions ;

(e) that the maintenance of the convertibility of the note into silver rupee of the present fineness was only possible so long as the price of silver remained at such a figure that the bullion value of the rupee was not higher than its exchange value ; but the system *would be upset* if the price of silver were to rise above 48*d.* per standard ounce (when the exchange is 1*s.* 6*d.* per rupee).

(f) that the *principles governing the efficiency of the reserves were not clearly recognized.* Their efficiency for the stabilization of the external value of the rupee depended upon :

(i) their maintenance at an adequate size,

(ii) their use in an effective manner.

In principle they should have been big enough to allow the Indian Government to sell sterling to any amount required in return for notes and rupees, and they must be used promptly and without conditions and the sales must be accompanied by an equivalent contraction of domestic currency. But they stated that "in the Indian system *these principles have not at all times been clearly recognized and they are not now and never have been adequately supported and enforced by statutory provisions.*"

There was, for instance, *no provision* as to any *organic relation between the total value of token currency and the amount of the Reserves*. So far as the note issue was concerned, the statutes provided for no minimum percentage of gold or sterling securities being held in the reserve as cover against notes.

*The amount of the Gold Standard Reserve and the time and manner of its use were wholly within the discretion of the Government.* This they pointed out to be the *greatest weakness* in the working of the Gold Exchange Standard.

(g) The fundamental basis of an automatic standard was provision for expansion and contraction of the volume of currency. As the reserve rises or falls with a favourable or unfavourable trade balance, the currency must be automatically expanded or contracted, and adjustment between internal and world prices maintained. But under the Indian system *contraction of currency was not and never had been automatic,* as is shown below :—

| Year | Reverses sold | Rupees received (*rupees in lakhs*) | Contraction affected (*rupees in lakhs*) |
|---|---|---|---|
| | £ | Rs. | Rs. |
| 1914-15 | 8,707,000 | 13,16 | 1,05 |
| 1919-20-21 | 55,53,2000 | 47,14 | 34,68 |

(2) SYSTEM IS NOT ELASTIC :—*We now take up the second weakness of the present standard.*

In India, there is a seasonal variation due to the requirements for financing the movement of crops. In order to provide for them, the currency authority is allowed by law to issue currency notes up to a maximum limit of Rs. 12 crores against *hundis.* This means that there ought to be a *plentiful supply of genuine hundis.* But in practice it is found difficult to secure an adequate number of them. And this difficulty is due to various factors, e. g., our internal trade is financed by a system of cash credits, so that on occasions the currency authority has been forced to use other means to give elasticity.

Besides, in case of a great financial crisis, when the need for additional cash for the support of credit is urgent, this system fails to provide for the emergency. The system is, in short, not elastic.

(3) DIVIDED CONTROL :—The third defect of the present system pointed out was that India was the only country in which the Government exercised direct control over the currency in general and over the note issue in particular. *Thus the banking and currency reserves were separated.* This diminished their capacity to effect their

specific purpose of stabilization in the most economical and efficient manner.

Moreover, Government control of currency reserves resulted in a dual control of the monetary policy. The Government controls the currency, but the Imperial Bank controls the credit. This results in *divided control,* whrch is likely to result in divided counsels, and failure to co-ordinate. The best course should be to concentrate the control in one hand.

CONCLUSIONS :—Owing to these defects the *system has not the confidence of the public because of its imperfections.*

"The evolution of Indian economic system has now reached the stage when her currency can and should be placed upon a more *simple, certain* and *stable* basis."

**(B) Alternative Proposals for Reform.**

The Commission considered the following possible *methods* of remedying the defects :

(i) *The perfection of the Sterling Exchange Standard.*

(ii) The adoption of the *Gold Exchange Standard.*

(iii) The adoption of the *Gold Standard with Gold Currency.*

(iv) The adoption of the *Gold Standard without Gold Currency.*

We shall deal with them one by one :—

**(I) The perfection of the Sterling Exchange Standard.**

They stated that the main defects of this standard *could be remedied by the following provisions :—*

(*a*) by a single currency reserve under the control of one authority, instead of two separate reserves, as at present ;

(*b*) by selling rupees for sterling without limit at the upper gold-point of a fixed parity, and by selling sterling for rupees at the lower gold-point of the same fixed parity.

By so doing the system would become elastic and efficient.

ITS INHERENT DEFECTS :—But in their opinion, in spite of this, the *inherent defects of the system could not be remedied.*

They were the following :—

(1) *If silver rose in price, the silver currency would be threatened ;*

(2) if sterling were to be divorced from gold, the rupee would also be divorced from gold ;

(3) if sterling depreciated, Indian prices would have to follow sterling prices, and the authorities would be compelled to raise the rate of exchange.

CONCLUSIONS :—"There is undoubted disadvantage for India in dependence upon the currency of a country, however stable and firmly linked to gold." India had experience of both these alternatives and the evils resulting from them are fresh in her memory.

**(II) The adoption of the Gold Exchange Standard.**

They suggested that this standard could be secured by providing that the currency authorities should be compelled by Law to buy and sell at the upper and lower gold-points respectively and to unlimited amounts, the *currencies of any of the principal foreign countries with a gold standard.*

By doing so the rupee would be stabilized in gold.

But they emphasized that there were serious defects in the system which would still persist.

OBJECTIONS AGAINST IT :—*We have already pointed out the evils of the Gold Exchange Standard.* The Commission made them again emphatic.

*The inherent defects, they said, were* :—

(1) that, if silver rose in price above the melting point of the coin, the rupee would vanish ;

(2) that *it had not the simplicity* which was essential to secure the confidence of the public. The mechanism of an exchange standard was refined. It required some knowledge of economics to understand it, and to the majority in India it was unintelligible. It was, therefore, *not suited to India.*

"The basic right of convertibility that supports an exchange standard is *too abstract* for the present conditions in India. The backing which it supplies for the token currency is too *intangible* and *invisible.* Without some backing more simple, more certain and solid, confidence in the stability of the currency can grow more slowly than it should." A backing more certain, simple and solid, must be provided. Indian public opinion will have confidence in one thing only, and that was *gold.* It would supply a real and visible link. They were thus led to the conclusion that it was necessary to establish a sure basis not only for the external, but the internal convertibility of the token currency of India *into metallic gold.*

### (III) The Proposal for a Gold Currency.

Mr. H. Denning, the Controller of the Currency, presented a scheme for a gold currency before the Commission.[1]

The *chief objects of the scheme* were—

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[1] This scheme was submitted in a Memorandum which represented the result of discussions which took place between Sir Basil Blackett (the Finance Member), Mr. McWatters (the Financial Secretary) and himself.

(a) to dethrone the rupee from its position as a standard coin of unlimited legal tender, so that the threat inherent in our present system of the rise in the price of silver would be eliminated ;

(b) to cure the uneconomical habit of the Indian people of hoarding the precious metals as a store of value, by assuring them through the instrumentality of a gold currency, that the same measure which they mete out, in gold value, by way of investment or deposit with a bank, will be meted to them again, in gold value.

THE ESSENCE OF THE SCHEME :—The scheme had for its essence the gradual and cautious adoption of a gold currency for India within *ten years* by various stages beginning with the buying and selling of gold bars by the Government. For, in the first place, the rupee could not be made limited legal tender unless the present holders were given an opportunity to convert them into gold. The estimate made for this demand for conversion was Rs. 110 crores. Secondly, sufficient gold would have to be accumulated for the eventual adoption of a gold currency. The total amount of gold required for introducing the scheme in all its stages was estimated at Rs. 137.2 crores.

(2) The rate of exchange suggested was 1*s*. 6*d*. per rupee.

(3) And the management of Paper Currency and the conduct of Government remittance were to be handed over to the Imperial Bank of India.

In concluding that a *Gold Standard with a Gold Currency in circulation* was the only method of completely remedying the defects of the Indian Currency System within a reasonable period, Mr. Denning wrote in his Memorandum :

"Undoubtedly, the ideal to be aimed at is the system now in force in Great Britain under which the note is the sole full legal tender in circulation, and the gold value of sterling is stabilized by the statutory obligation imposed on the Bank of England to buy and sell gold at rates corresponding roughly to the par of exchange. It is impossible, however, to hope that conditions in India will for generations be such that a full legal tender metallic currency will be no longer necessary. *If, therefore, a gold currency is not introduced, defects in the Indian currency and exchange system must remain indefinitely.* There is, moreover, reason to suppose that the introduction of a gold currency would hasten the attainment of the ideal system, as the fact that notes were convertible into gold and not merely into an over-valued silver coin would tend to increase confidence in the note issue and to decrease the demand for metallic currency. The conclusion is that the only way of remedying all the defects in the system within a reasonable period is by establishing a gold standard with a gold currency in circulation".

**The Gold Currency Scheme was rejected.**

The Commission, after carefully considering the scheme, rejected it. They considered various important points in connection with this scheme.

(A) EFFECT OF INDIA'S DEMAND FOR GOLD :—In the first place, they took into account the effect of the absorption by India of enormous quantities of gold (estimated at Rs. 137.2 crores in addition to the normal demand for arts, hoards etc.) on the supplies of credit, the rate of interest, and gold prices, throughout the world.

From the evidence which they received from eminent

men like Professor Gustav Cassel and Mr. Joseph Kitchin, they were led to conclude that unless economy was exercised in the use of gold, a prolonged period of steadily falling commodity prices in the world was expected. Various European and other countries were trying to return gradually to the gold standard or the gold exchange standard after the War. To their demand for gold would be added the extra demand from India, which would cause increased competition for gold, and *lead to a substantial fall in gold prices and a substantial curtailment of credit*. And the fall in gold prices and curtailment of credit would on the balance be unfavourable for India.

Besides, it was expected that the United States of America was not in a position to spare the gold that India would need every year.

(B) UNCERTAINTY AS REGARDS AMOUNT AND TIME OF GOLD DEMAND :—It was also uncertain what amount of gold would be necessary for gold currency every year, nor was there any surety that the additional demand for gold would be spread over the period of 10 years, as required by the scheme.

On the contrary, there was the possibility of a *part of the notes being replaced by gold which had its own attractions for the Indian public*.

Besides, the decline in the value of silver resulting from the proposal of gold currency would lead to a loss of confidence by the people, and its value would diminish as a store of value, and gold would be absorbed in much larger quantity for non-monetary purposes.

It was suggested before the Commission that if gold currency were introduced into circulation and if exchange were stabilized, the result would be so to increase confidence that gold would come out from the hoards into

circulation and for investment. But in the opinion of the majority the mere act of putting gold into circulation would not develop the banking and investment habit.

The scheme also involved the reduction of the proportion of gold and sterling securities in the Reserve to gross note circulation, during the transition period, to 30 per cent. That proportion was, in the opinion of the majority, too low for safety, especially during a bad year in India.

The estimate of the initial demand for gold laid down in the scheme was Rs. 50 crores. But the majority would not put reliance on this limit. For they considered that, as soon as it would become known that the status of the rupee was threatened, holders would probably get rid of every rupee they could spare and get the silver coins converted into gold coins.

In conclusion, if, the amount of gold needed and the period of absorption of 10 years increased, the difficulties would be intensified and the cost of the project would be increased.

(C) EFFECTS ON CHINA :—They also dealt with the effects of the proposals on China. The catastrophic fall in the price of silver in terms of gold, which would take place, would induce China to demand gold as a basis for instituting gold as the standard instead of silver. This would lead to a reaction on Chinese trade, and as China is a growing market for Indian cotton and cotton goods, India would suffer in turn.

(D) RAISING OF THE REQUIRED CREDIT :—As regards the question of credits, Great Britain would not be able to act alone without the co-operation of America.

But the United States of America would not support

a scheme which would give a death blow to her silver market, for she has had traditional interest in silver, so that there would be unsurmountable difficulties in obtaining the necessary credit.

(E) EFFECT ON SILVER HOARDS :—They also considered the effect on silver hoards, which are the only store of value for the poorer classes. These are deeply interested in the value of silver bullion, and by instituting a gold currency their store of value would depreciate nearly 50 per cent. This would mean heavy losses for the poorer classes.

(F) EFFECT ON THE SILVER MARKET :— Besides, the *future of the silver market was* quite uncertain. However, from well directed enquiries they came to the conclusion that there would be a diminution in its demand in the future. To add to this, if gold currency were resorted to by India, it would mean augmenting the demand for gold, which threatened to be in increasingly short supply, and would lead to a further depression of the gold price of silver.

CONCLUSION :—Sir Basil Blackett wrote in his memorandum, "if the effect of a decision to attempt the change to gold in India is going to be to upset the gold standard in the United States or in Europe, *India has clearly nothing to gain by the attempt.*" In the opinion of the Commission the attempt would be very likely to have the consequences to which he referred. It would upset the monetary standards of various countries and lead to higher interest rates and economic depression, which would react on India. They, therefore, rejected the scheme.

### (IV) The Gold Bullion Standard.

Before outlining their scheme for a standard most suited to India, they emphasized the economic reasons against gold in circulation.

ECONOMIC REASON AGAINST GOLD IN CIRCULATION :—If gold in the reserve were transferred to circulation, the *structure of credit* that can be built on the reserve would be *reduced ;* so that the greater the proportion of gold in circulation the less would be the elasticity of the currency system. "In a system that consists solely of gold coins there could be no elasticity, because the currency could only be increased by taking payment in gold for the balance of exports over imports and it could be decreased by the contrary process only." In short, the less the gold in circulation, the more will be the gold in the reserves and the greater the elasticity of the structure of credit that can be built thereon. *Gold in circulation is of uncertain value for the support of exchange.*

What then was the currency system which they favoured? The system they recommended for India may be described as the *Gold Bullion Standard.*

ITS ESSENTIALS :—The ordinary medium of circulation in India, they observed, should remain as at present—the currency note and the silver rupee. Although gold should *not actually circulate* as money, gold would be made the standard of value and the rupee would be linked to gold. "It *must* not circulate at first and *need* not circulate ever."

In order to secure this, *an obligation was to be imposed by Law on the Currency Authority*—

(a) *to buy and to sell gold bars without limit* at rates determined by the fixed gold parity of the rupee ;

(b) but in quantities of not less than 400 fine oz. (i. e. 1065 tolas.)

(c) *no limitation* being imposed as *to the purpose* for which gold was required. The fulfilment of this obligation would secure the stability of the gold value of the rupee and stability of exchange within specie-points.

Since gold bars were to be given in exchange for notes or silver rupees, *not for export only but for any purpose,* this was not an exchange standard. "It *is an absolute gold standard.* Nevertheless the compensatory mechanism of the exchanges is preserved, because gold bars are not currency." When gold bars are given by the currency authority in exchange for notes or rupees, the currency becomes *contracted* ; and when the reverse process takes place, the currency is *expanded.* It establishes the principle that "*gold is the standard of Indian currency at a fixed ratio, and that the currency authority admits it, and must maintain it.*"

THE LIMITATION IN THE CASE OF INDIA :—A sound gold standard postulates a statutory obligation upon the currency authority to buy and to sell gold at a price which is equal to the par value of the monetary unit.

This obligation constitutes "the *cardinal condition and compelling force*" for the maintenance of the stability of the gold value of the rupee and through it the stability of exchange.

But, they stated, "in the case of India there is a difficulty in the way of imposing this obligation in this form". India demanded gold both for monetary and purely social uses, and this latter was to be seriously taken into account. *For social uses India had always absorbed gold in important amounts,* and was likely to do so in important

amounts in the future. In India at the time an admirably organized bullion market supplied the needs of the public for gold, and the price at which gold was sold included the cost of importing it and profits of the sellers. But if the currency authority were compelled to sell gold at a *price exactly equal to the par value of the rupee,* it would not take account of these items, and it would become the *cheapest market* for gold in India. Therefore, not only would the bullion market be destroyed, but it would also be *extremely difficult to maintain the value of the monetary unit at parity with gold.* For in order to satisfy the demand for gold, the authorities would have to attract a steady flow of gold into its reserves, and the means to do so would be a *rigorous and continuous contraction of credit* which would be detrimental to the economic progress of India.

"It is essential, therefore, that the conditions which are to govern the sale of gold by the currency authority are to be so framed *as to free it in normal circumstances from the task of supplying gold for non-monetary purposes.*" In order to achieve this object, they made proposals for fixing the selling prices of gold. This, then, was to be the limitation in the case of India.

But India would retain complete freedom to buy gold in the market as then and the bullion market would remain the ordinary source of supply of gold for non-currency purposes. The currency authority would not supplant the bullion market or be involved in supplying gold for ordinary internal demands for non-currency purposes.

SUBSIDIARY RECOMMENDATIONS :—Various recommendations were also made by the Commission as a result of this adoption of the Gold Bullion Standard.

(1) *That the buying and selling of gold bars by the*

*Government made it impossible to have any gold coin as legal tender. Thus the sovereign would have no place as legal tender.*

(2) That in order to have some direct means of making the standard known to the masses, gold *savings certificates,* redeemable in three or four years and yielding interest to one who buys it, were to be issued.

(3) That *new notes* were to be issued which should be made *convertible into gold bars* and not in silver rupees. Thus a more solid right of convertibility was attached to them than they ever had before. But the old notes must continue to be converted into silver rupees.

(4) That *the coinage of the Rupee should be stopped* until the rupees in circulation were reduced to the amount required for small change. The object was to enable silver to be eliminated in course of years.

(5) That *one-rupee notes* should be re-introduced, but should not be convertible by Law into silver rupees.

(6) That the *Reserves should be amalgamated and the proportions and composition of the combined Reserve should be fixed by Law.* This was a provision essential to any currency system in order to secure the automatic expansion and contraction of the currency and their effect on the exchanges in accordance with the needs of the country. Thus they laid down *that gold and gold securities should form not less than 40 per cent. of the total.*

THE ADVANTAGES CLAIMED FOR THIS SCHEME :—The first great advantage claimed by the Commission for their proposed system was (1) that it was so simple that it would establish confidence in the stability of the currency very quickly. This standard fulfilled the essential condition that it should not be *stable* merely but *simple* and *certain*. It provided the token currency with a right of convertibility that was intelligible to the uninstructed, and with a *backing that was tangible and visible*.

(2) That those who advocated the introduction of a gold currency stated that a token currency of notes inconvertible for internal purposes was the ideal end towards which India should work. The scheme suggested by the Commission carried India very far along the road towards the end. The scheme had the advantage of setting up almost immediately a full gold standard (as a preliminary to the ultimate adoption of gold currency).

(3) That there had been general agreement that it was difficult to introduce gold currency at once. The alternative, therefore, was to make provision for the gradual strengthening of gold reserves in such a manner as to avoid disturbance to the world's gold and silver market, whilst incurring the minimum of expense. This would certainly not upset prices and disturb Indian business and trade. The scheme proposed would do this successfully.

(4) That apart from the economic loss to India, the existence of a large volume of currency in the hoards was a formidable obstacle to the efficient working of any currency system. As long as the circulating media of the country, whether silver coin or gold coin or notes, were employed for hoarding, the control of the currency authority over expansion and contraction of currency would be

uncertain and there would be a possibility of fluctuation of prices. And the mere substitution in the hoards of one kind of coin for another was no remedy at all for this evil.

But the system encouraged the habit of banking and investment by creating confidence and discouraged the habit of hoarding precious metals.

**The Real value of these Recommendations.**

In order to judge the value of the advantages claimed by the Commission for their scheme of a restricted 'Gold Bullion Standard' it is necessary to analyse their proposals further.

**(A) External stability of the rupee.**

In order to maintain the *external* value of the rupee they proposed that the Reserve Bank (which will be the Currency Authority) shall be under obligation[1]:

(a) to buy gold bars of not less than 400 fine ounces without limit when tendered in India at the par rate of Rs. 21-3-10 ps. = 1 tola (180 grs.) of fine gold. This is according to the *ordinary gold standard practice* and also pre-war practice in India ;

(b) to sell gold bars without limit for delivery in London at par rate plus a charge covering the total cost of shipment to London and loss of interest. These sales are intended to serve a monetary purpose when there is adverse balance of trade. This is *the common gold exchange standard practice ;*

(c) and to sell gold bars without limit for delivery in Bombay. The gold in Bombay will be required for two purposes : (1) *monetary*, when a favourable balance of

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[1] The section is almost wholly taken from the Author's : *A Reserve Bank for India and the Money Market*, pages 34-37.

trade is to be liquidated and (2) *non-monetary*, for social uses. In this case there are limitations applied :—

(i) Gold will be sold at par rate (for monetary purposes) *only when exchange is at or above upper gold point ;*

(ii) but at all lower levels of exchange the selling charges for gold (for non-monetary purposes) will be par plus *twice* the shipping and interest charges (and not a single charge).

The effect of limitation (i) will be that at that point of exchange gold will flow into India in the ordinary course to liquidate the favourable balance of trade, so that it will not be very necessary for the Reserve Bank to sell gold.

Whereas the effect of limitation (ii) will be to charge such a prohibitive rate that the public would not buy gold for non-monetary uses from the Reserve Bank, which will consequently preserve its gold stocks for purely monetary purposes. A deterrent rate is, therefore, applied. For the same purpose they have proposed certain rates making it cheaper to import gold from London than to buy it from the Bank when the exchange is *below upper gold point*. A method of computing the rates for buying and selling gold is laid down by the Commission in a special schedule.

The consequences of these proposals will be that (1) India's Standard will be based not on Sterling but on Gold. When the balance of trade is favourable to India, gold will be allowed to flow freely to India, and when the trade balance is unfavourable gold will flow out of India. (2) But the relation between the rupee and gold will be supported by the two obligations on the Reserve Bank to buy in India gold at par, and to sell gold in India for delivery in *London* at the rate proposed.

It will be seen from the above provisions that actually gold will *only be sold* by the Reserve Bank of India when, owing to an adverse balance of trade, *the exchanges turn against India* and gold is demanded by the public for meeting their foreign obligations.[1] The result is inevitable that there is no difference between the Gold Exchange Standard and the "Gold Bullion Standard" as proposed by the Commission and there is no room for the advantages claimed by them to exist in practice.

#### (B) Internal stability of the Rupee.

As regards the internal stability of the rupee they proposed to solve satisfactorily the twofold problem :

(i) how to inspire the masses of India with confidence in the currency standard, which they have lost, and

(ii) how to remove once for all the threat to the currency system inherent in the price of silver—'the rupee melting-point'?

For the solution of this problem the measure they suggested was the establishment of *gold bullion as the backing for both notes and rupees* and therefore the ultimate withdrawal of the right of converting notes into rupees.

Their chief proposals were as follows :—

(1) The *new* notes of the Reserve Bank of India (guaranteed by the Government of India) and *rupees* both were to be *full legal tender* and convertible on demand with *bars of 400 oz. fine gold* (or 1065 tolas).

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[1] Even this is questionable. At 1*s*. 6*d*. rate the rupee price of one tola of fine gold is Rs. 21-3-10. But when the upper gold point is reached i. e. when the exchange is 1*s*. $6\frac{3}{16}$*d*., the rupee price of one tola of fine gold will be *less* than Rs. 21-3-10. If then the Reserve Bank offers to sell gold at the *par* rate of Rs. 21-3-10, who would buy gold from the Bank?

(a) *at par* when exchange is at or above upper gold point;

(b) but otherwise i. e. *normally*, at a *discount* (which is about $2\frac{1}{4}$ per cent. below parity as recommended by them in their detailed schedule).

(2) The *new* notes were *not* to be *legally convertible into rupees* but were to be freely encashed in practice, if people desired to exchange them for rupees.

It is indeed difficult to see how these limitations are going to inspire the masses of India with confidence?

(1) In the first place, in order to supply a backing for token currency which is 'tangible', 'visible' and 'intelligible' to the masses, the *greatest requirement is that token money whether silver rupees or notes, should be freely convertible into gold bars for internal use. But this is not provided for by the Commission.* The token money will in practice be convertible into gold bars for *export merely* and *not for internal use.*

(2) Secondly, *normally*, the new notes would be convertible at a *discount*, and as the rate for conversion would be fluctuating, a gold note would not entitle the holder to receive a fixed quantity of gold in return. Besides, the minimum exchangeable weight of gold bars laid down is 400 oz. (1065 tolas) i. e. in value of nearly Rs. 22,600 at a time—a limit which is beyond the means of an ordinary purchaser.

For these reasons, in practice, it is impossible to expect that the new note will be in ordinary daily use in India. Its value will be in *foreign exchange*, but are the crores of Indians who form the masses at all concerned with foreign exchange? From the point of view of convertibility, then, there is no difference between the present 'Gold

Exchange Standard' and the proposed 'Gold Bullion Standard'.

**(B) The establishment of "The Reserve Bank of India".**

The second principal recommendation of the Commission was regarding the authority controlling the working of the standard. That authority, they wrote, should be a Central Bank, called "The Reserve Bank of India". It is, therefore, necessary to have a *general idea* of the object and functions of a Reserve Bank (or a Central Bank).[1] The scope of the present volume necessitates the statement of the sketchy outline of this subject.

I. A RESERVE BANK'S NOTE ISSUE IS ABSOLUTELY NECESSARY :—Whenever a Reserve Bank is established, it has followed almost as a natural consequence that it is given the *sole right of note issue* and the responsibility of maintaining the *stability of the currency*. This is so because the institution which supplies credit must also be the institution which should supply currency. The amount of credit to be extended in a country depends not merely on the demand for it but also on the amount of currency available. If credit is to be fully supplied by a Reserve Bank, currency must also be in adequate supply. An equilibrium between the quantity of credit and currency must be obtained if the money market has to be adequately supplied with credit. In short, *credit and currency must be co-ordinated in a single institution*, then alone the evils of inflation and deflation can be averted.

Besides, being in intimate contact with the money market a Reserve Bank is in a position to know *con-*

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[1] The subject of Reserve Banking has been exhaustively dealt with in the Author's *A Reserve Bank for India and the Money Market*, Chapters IV-VIII.

*stantly,* more *accurately* and more *quickly* the day to day demand for currency than a Government can. It knows best when to expand and when to contract currency without causing any disturbance to the money market. If, therefore, the Reserve Bank is able to establish an equilibrium between the demand and supply of currency at a given time, it will have reached the goal of maintaining the *stability of the value of the monetary unit.*

Whenever a Reserve Bank is established its note issue is generally backed by a reserve of gold, securities and *bills of exchange.* When a note issue is partially covered by bills of exchange, the issue of notes becomes not merely *automatic* but *elastic.* Thus, when notes are issued on the security of bills, money flows out of the Reserve Bank ; but when the bills get matured, money comes back to the Bank. A bill is a *self-liquidating asset* and in times of emergency it becomes possible to make the issue elastic because such an issue is represented by bills which show genuine trade demand for them.

Nowhere is this unity of control of currency and credit more urgently needed than in India, where the two are managed in a divided control. The Government of India controls the currency but the Imperial Bank of India controls the credit, although this control is generally inappreciable. From this divided control results the *divided management* of the currency and banking reserves of the country and the consequent difficulty of maintaining monetary stability.

II. A RESERVE BANK IS NECESSARY FOR THE MONEY MARKET :—It follows from what was stated above that a Reserve Bank is necessary for the controlling and managing the currency and banking re-

serves of a country. Whenever a Reserve Bank is instituted, whether by legislation as in the United States of America (which has a Federation of 12 Reserve Banks) or by custom as in Europe, the scattered reserves of the banks of the country get centralized in the vaults of the Bank. This centralization has great economic value to the commercial banks of a country. It is of immeasurable strength when any emergency such as a panic occurs and a commercial bank is in great danger. At such a moment the combined reserves could be moved by the Reserve Bank easily and almost at a moment's notice to meet the bank's needs. Scattered reserves are unwieldy and incapable of being moved from place to place, and are least effective in times of stress. It is not so with a combined Reserve, because like the mobilized mass formation of an army, it could be thrust upon a line, if that line is in danger of breaking. It is in this respect then that a Reserve Bank is able to play the part of a *Bankers' Bank*.

The centralization of the Reserves also enables the Reserve Bank to extend its credit facilities liberally to the money market in times of emergency, because the combined Reserve forms a big heap of sinews as a backing for credit. It is this centralization of the banks' reserves that also empowers the Reserve Bank to keep a watchful eye and a direct control over the commercial banks and gives it that dictatorship in the money market so essential for credit mobilization. In this respect the Royal Commission recommended that all commercial banks in India should be compelled by law, as in the United States of America, to maintain minimum reserve balances with the Reserve Bank. These balances were to be 10 per cent. of their *demand* liabilities and 3 per cent. of *time* liabilities to the India public.

(b) If the foundation of credit organization is to be truly laid a Reserve Bank should be in possession of such an instrument that at a moment's notice it could safely advance money to commercial banks in time of stress. That instrument is the *rediscount of bankable bills*. If, for instance, there is an unusual demand on the banks for cash from businessmen for, say, financing the moving of crops, and these banks have already in their possession bills which they have discounted. To meet this unusual demand, the best and the quickest way open to them is to take these bills to the Reserve Bank and get them *rediscounted and obtain cash* for them. Thus the assets of these banks get immediately *liquidated*. Besides, by such an operation, the Reserve Bank pours out cash in exchange for bills and thereby expands currency, and when the bills get matured it receives back cash, which leads to a contraction of currency.

(c) Further, by raising the price offered for reserve funds or by lowering it, the Reserve Bank makes borrowing by commercial banks difficult or easy, whenever in the interest of the money market it considers such a step necessary. The weapon so used is the *rate of discount*. By the regulation of the discount rate the Reserve Bank so adjusts the supply of credit to the demand for it from business that an equilibrium is obtained and the money market is not merely completely satisfied but the Reserve Bank is able *to establish its credit policy* over the market.

(d) Finally, when the Reserve Bank becomes the currency authority a two-fold function devolves on it. It shall be incumbent on it to supply foreign exchange to businessmen, and in order to maintain the stability of the monetary unit a statutory obligation shall be laid upon it to buy and sell gold at prescribed rates.

III. A RESERVE BANK IS NECESSARY FOR GOVERNMENT'S BANKING BUSINESS :—If a Government keeps its own Treasury and receives and makes payments to the public directly through it, this operation cannot be as economical and in the interest of the money market as in the case of a Reserve Bank. If a Government itself undertakes transactions such as the collection of taxes, issue of loans and remittance operations, they are bound to affect the money market at one time or another. But a Reserve Bank being in control of the money market can undertake such tasks and manage them *smoothly* and *effectively* and *without disturbance* to money rates and thereby to the money market. Besides, it is in the very nature of banking business to undertake such operations. The Reserve Bank could also handle the cash balances of the Government economically and effectively by using the idle surplus in giving relief to the money market and in developing the country's industry and trade.

IV. RESTRICTIONS ON THE BUSINESS OF A RESERVE BANK ARE NECESSARY :—From the principal functions of a Reserve Bank outlined above, it follows that the Bank should be the safest institution for the country. There ought, therefore, to be various restrictions placed on its business. Thus it is essentially necessary that ordinary commercial business should never form a part of its transactions, for such business must bring with it great risks and dangers and at the same time make the Bank a serious rival to the commercial banks, whom it ought to protect and help rather than crush them out by its overwhelming influence and power. Similarly, it shall not advance money on mortgage of fixed property or make insecure loans or advances or accept money on

deposit for fixed terms or allow interest on current accounts. It should not also draw or accept bills payable otherwise than on demand. Further, it should not engage in trade or have any direct interest in any commercial, industrial or other undertaking not specially provided by its permissible business. It may be said that discounting and rediscounting bills are themselves commercial business and should not therefore form a part of the Bank's functions. But it is permitted to undertake such business *only in the interest of the money market* and is fenced round by various restrictions as to the quality of the paper, its maturity and so on.

It shall not also purchase its own shares or shares of any other bank or corporation. Restrictions should also be placed on the profits of the Reserve Bank in order to eliminate the possibility of the Bank doing any kind of speculative business. A *limit* is therefore put on the *dividends* which it shall give, if the Bank is constituted on a shareholders' plan.

GENERAL FEATURES OF THE PROPOSED RESERVE BANK :—Some general features of the Reserve Bank suggested by the Commission for India need mention :—

(a) Its capital shall not be very large ; 5 crores is sufficient.

(b) A fixed preferred dividend is suggested for payment to the shareholders and a share of profits to the Government.

(c) Its administrative machinery is to be on the same lines as that of the Imperial Bank of India.

(d) It is clearly laid down that this great bank should be free from political pressure and its constitution

is made democratic. There is to be a Central Board of 14 members, 9 elected and the rest nominated.

(e) No member of a Legislative Council can be nominated on the Board nor is the representative of any commercial bank to be appointed on it.

(f) Its destination shall be Bombay.

Various suggestions have also been laid down in details with regard to its Reserve Fund and the share of the Government.

COULD THE IMPERIAL BANK BE THE RESERVE BANK? :—*But, who was to be entrusted with these functions?* It would be either the Imperial Bank of India or a new institution which could substitute it. But they stated that the Imperial Bank would not be suitable in discharging the duties of a true Central Bank, and that was so for various reasons: It would be precluded from undertaking a great many tasks which it already performed as a commercial bank successfully. The country would then lose the benefit of the elaborate and widespread organization which had been set up throughout India for giving banking facilities in this country. Far from that, the Bank should be freed altogether from the restrictions imposed upon it by the charter, and which had their origin in the hybrid character of the functions which were originally assigned to it. Therefore a new organization was found necessary, and the Imperial Bank itself with its various branches could work as the Agent of the Central Bank.

## SECTION I—Ratio of Stabilization.

V. RATIO OF STABILIZATION TO BE 1*s.* 6*d.* :—For the reasons given below, the majority recommend the rate of exchange to be 1*s.* 6*d.* for the rupee (in relation to gold).

I. ADJUSTMENT OF INDIAN TO WORLD PRICES :—(a) The chief reason they stated was that, at the exchange rate of 1*s*. 6*d*., prices in India had already attained a substantial measure of adjustment with those in the world at large, and that any change in the rate would mean a difficult period of readjustment. It would lead to wide-spread economic disturbance which had to be avoided.

If it can be shown that prices had to a great degree adjusted themselves to the existing *de facto* rate, then that rate must be adhered to and that such an adjustment had taken place was a *matter of fact*.

At the outset they recognized that "*index figures are not an infallible guide,* and that there are many directions in which they might lead one astray—*In India there are special difficulties in the way of compiling a representative* index figure owing on the one hand to the great size of the country and the cost of inland transport, and on the other to defects in the statistics on which the compilation is based."

Bearing the above reservations in mind, they proceeded to examine the data available to prove that 1*s*. 6*d*. was the *de facto* ratio, and in doing so, they took into account the indices of wholesale prices compiled at Calcutta and Bombay, and especially the former.

## Mutual adjustment of prices and exchange to world price level.

| No. | During period | Rate of exchange (nearly) | Rupee price level | World gold prices |
|---|---|---|---|---|
| 1 | December 1922—June 1924 | 1 *s.* 3 *d.* gold | 176 (limits 170 and 181) | Approximately the same |
| 2 | July 1924—January 1925<br>—June 1925 | Sharp rise to<br>1 *s.* 6 *d.* gold<br>1 *s.* 6 *d.* gold | Fell from 179 to 157 | The period of adjustment |
| 3 | June 1925—March 1926 | 1 *s.* 6 *d.* gold | 158 (limits 163-153) | Approximately the same at the end of the period |

The data given by the majority have been arranged in a tabular form as above. Treating the statistics in the most generalized way and disregarding minor movements, the conclusions drawn by them were that—

(1) During the 18 months, while the rupee was worth about 1*s.* 3*d.* gold, the rupee price level ranged round a mean of about 176.

(2) In the succeeding year, while the rupee was rising to 1*s.* 6*d.* gold, the rupee price level *fell below 160.*

(3) Since then, while the rupee had remained, or had been held, at about 1*s.* 6*d.* gold, the rupee price level had ranged round a mean of *about 158,* with a recent tendency to fall in sympathy with world prices. But the *level of world gold* prices, as indicated by the wholesale price index figures of the United States of America and the United Kingdom, was (in spite of intermediate fluctuations) *approximately the same* at the beginning of period (I) and at the end of period (III).

CONCLUSION DRAWN :—Thus, "it is natural," they stated, "to conclude that, during the period of change, there was a mutual adjustment of prices and exchange, and that a substantial *equilibrium was attained* about the middle of 1925 and has been since maintained."[1]

(b) A further indication of the equilibrium between internal and external prices during the last 12 months preceding August, 1926, was to be found in the *steadiness of exchange.* Exchange is the mechanism by which differences in these two price levels are adjusted and by which they are kept in unison. When exchange remains

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[1] They also showed the nature and extent of the tendency towards adjustment by means of graphs, and the reader is referred to paras 185, 186, and 187 of the Report.

steady over a fairly long period, it may be inferred that there are no differences to be adjusted. Thus as the exchange was steady over a long period, it meant that the Indian prices had adjusted themselves to the world prices.

(c) It was relevant also to consider the course of India's foreign trade. It would naturally be affected by any disequilibrium between external and internal prices. But the general trade of the country taken as a whole showed no sign of the imposition of this disequilibrium. The foreign trade was steady and there were no adverse circumstances.

II. ADJUSTMENT OF WAGES :—The majority inferred on general grounds that considerable progress had been made in the process of adjustment of wages with the present level of prices and exchange. Prices were bound to react on wages and particularly so in India, because a much larger percentage of wages was spent on food-stuffs than in Western countries and that therefore there was a very necessary ultimate adjustment of wages to the price of food-stuffs. And this was true as recent history of Indian prices manifested itself.

Then again, were exchange and prices steady over a considerable period, one should feel justified in assuming that wages were in adjustment, unless there were any clear indications to the contrary.

The statistics of foreign trade strengthened the assumption. Nor was there any indication of any maladjustment of wages paid by manufacturing industries generally.

III. EFFECT ON CONTRACTS :—It was also relevant to consider how contracts would be affected by the 1*s*. 6*d*. ratio.

(a) In the first place, it was true that the Land Revenue

and other long-term contracts were settled when exchange was at 1*s*. 4*d*., but they stated that, in view of the great rise in prices since 1914, the real incidence of Land Revenue measured in terms of commodities had been very materially lightened, and that the 1*s*. 6*d*. ratio would not be a hardship in this respect.

(b) Besides, it could be contended that contracts concluded prior to 1918 bulked more largely in the economic life of the country than those concluded after 1918, during which period the exchange was in a state of flux.

After the prolonged disturbances which had taken place, it was impossible to do justice to the long-term debtor or creditor by fixing any particular ratio of exchange.

Thus, they concluded that the least disturbance would be caused and least injury done to all interests by adhering to the *de facto* ratio.

MAJORITY'S CONSIDERATION OF THE ARGUMENTS FOR REVERSION TO 1*s*. 4*d*. RATIO :—(1) It was argued that 1*s*. 6*d*. rate came into being through Government manipulation of the currency, and that a rate so established could be disturbed with less harmful results than would follow from the disturbance of the rate which has been produced by the interplay of purely commercial forces.

The answer of the majority was that, in the first place, this was not supported by facts, and that in the final stabilization of the rupee it was the facts of the present that must be faced. When prices and other factors were in adjustment with those in the world at large on the basis of an existing exchange rate, the question of the means by which that rate came into existence had no bearing on

the extent or violence of the economic disturbances which would result from an alteration in the rate.

(2) It was said that the 1*s*. 6*d*. ratio would accentuate the fall of prices in India resulting from the fall of world gold prices, such as took place in the year 1920.

But the Majority stated that this was quite unlikely to happen. The economic conditions of the time were very different from those that prevailed in 1920. Besides, if the world's gold production in the future should fail to keep pace with the demand, a period of falling prices would set in. But experience showed that the price movement due to such a cause would be slow and gradual.

Certainly India would suffer with the rest of the world from a long period of depression resulting from falling prices, but they stated that this risk would be there whether the exchange were at 1*s*. 4*d*. or at 1*s*. 6*d*.

(3) The Majority stated that the reversion to 1*s*. 4*d*. would affect the budget very much adversely and that immediately. They estimated the loss per annum at somewhere near Rs. 6 crores. This would certainly mean an increase in taxation, and also as regards the railway budget, an increase in rates and fares. And these in their turn would disturb the trade and the commerce of the country, and increase the cost of living of salaried servants.

(4) They stated that a reversion to 1*s*. 4*d*. would mean a general rise in prices of $12\frac{1}{2}$ per cent., a change which would be severely felt by consumers generally, and specially by the poorer classes. It would also mean an arbitrary reduction of the real wages of labour.

(5) They stated that the effect of the change to 1*s*. 4*d*. on foreign trade would be immediate and for a time

convulsive. The sudden fall in exchange might create a boom which would be followed later by a slump.

SECTION II—**Arguments of the Minority.**

(I) IS 1*s*. 6*d*. THE *DE FACTO* RATIO? :—Sir Purshotamdas Thakurdas, in his minute of dissent, stated that to fix the rupee at 1*s*. 6*d*., because it was the *de facto* rate, was a premise which was *not entitled* to the slightest weight. The reasons for this strong opinion were many. In the first place, the legal standard of money recommended by the Herschell Committee was 1*s*. 4*d*., to the rupee and this remained effective up to 28th August, 1917, for a continuous period of nearly 25 years, and although it was disturbed during the War, it was the action taken on the Babington-Smith Committee that deliberately threw it out as the *de facto* ratio, and fixed an unnatural rate of 2*s*. gold.

THE OPPORTUNITY OF 1924 :—But when the attempt to stabilize it at 2*s*. gold was abandoned, and the rupee was allowed to adapt itself to the market conditions, it reached approximately *1s. 4d. gold in September, 1924*. Here then was an opportunity to stabilize the rupee at its long established legal standard of money payments ; but in spite of the suggestions in the Legislative Assembly to restore it, the Government of India declined to favour these proposals. Besides their telegram of the 11th October 1924 (when exchange was about 1*s*. ½*d*. gold) to the Secretary of State, "shows that their policy then was to look for, in other words, *a permanently higher rate than 1s. 4d. gold*. Subsequently, when in April, 1925, the pound sterling reached gold parity, the Government of India were able to talk of this new ratio as 1*s*. 6*d*. gold, instead of 1*s*. 6*d*. sterling."

**How was 1s. 6d. reached?**

Further he considered how the rate of 1s. 6d. sterling was reached. According to him the rupee was maintained at 1s. 6d. by *"the official administration of the currency."* There was deflation of currency accomplished by preventing the expansion of the currency to the extent normally required by India, as was shown in the following table :—

| Annual Average | Expansion of currency |
|---|---|
| Pre-War | Rs. 20 crores (and above) |
| 1921-25 | Rs. 11·12 crores |

(*a*) DEFLATION OF CURRENCY :—It might be argued that deflation was necessary during that period in the interest of the country. But there were circumstances which went to prove that *more currency was deflated than was required* (or the normal expansion of currency was prevented).

(1) In the first place, the Imperial Bank of India rate went as high as 8 per cent. towards the end of 1923, and remained there for the first half of 1924.

(2) The fact that there was stringency in the market was even admitted by the Government to be the result of "the direct outcome of Government action in contracting currency, or rather in placing strict limits on possibilities of expansion."[1]

1 The Viceroy's telegram to the Secretary of State, dated the 8th October 1924.

He also referred to a telegram of the Secretary of State to the Viceroy dated the 10th October, 1924, in which he expressed himself as follows:—"It seems to me, however, that the vital consideration is not so much the actual level of exchange at the moment as the avoidance of such abnormal stringency as might threaten the financial and economic position."

(*b*) NATURAL CORRECTIVE MADE IMPOSSIBLE :—Whilst the currency was being administered in this manner, the *natural corrective to the rise in exchange*—the tender of gold at the currency offices—*was made impossible* for practical purposes by the retention of the fictitious ratio of 2*s*. on the statute book. The gold imported into India could not function as currency and was a mere commodity.

RATIO NOT ESTABLISHED SINCE OCTOBER 1924 :—Besides, the contention that 1*s*. 6*d*. ratio was the *de facto* ratio because it had been established since October, 1924, had no truth in it. Sterling *had no parity with gold till June, 1925.* From *October, 1924, onwards the rupee was not 1s. 6d. gold,* but 1*s*. 6*d*. sterling. The rupee did not reach 1*s*. 6*d*. gold till June, 1925, when sterling reached gold parity, and this rate had, therefore, prevailed only for a year.

### II. No adjustments of prices to a 1s. 6d. ratio.

Sir Purshotamdas next considered the statistics produced by the Majority to prove that at the rate of 1*s*. 6*d*. per rupee, prices in India had already attained a substantial measure of adjustment with those in the world at large. He divided his examination of prices [1] into three main parts.

(1) PRICES FROM JUNE, 1925, TO FEBRUARY, 1926 :—After the rupee touched 1*s*. 6*d*. in June, 1925, for six months there was a rise in the Calcutta Index Number. But sterling reached its pre-war parity in June, and the index number of sterling price was 158. Since then it steadily *fell* to 149 in February, 1926.

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[1] "We had before us a statement from which I have taken the figures used by me in this note. The figures relied on by my colleagues are also based on the same statement." Sir Purshotamdas Thakurdas.

| Period | Calcutta Index number | Sterling prices |
|---|---|---|
| June, 1925 ... | 157 Steady rise | 158 Steady fall |
| January, 1926 | 163 | |
| February, 1926 | 158 | 149 |

Thus, as the table shows, while there *was a fall of 9 points* in the British Index Number, there was, on the contrary, a *rise* of one point in the Calcutta index number (when the rupee touched 1*s*. 6*d*. gold).

Then again, from the following table the conclusion becomes inevitable that the fall in the Bombay prices was due to the *fall in gold prices themselves over the world* and *not to any adjustment of the Indian prices to* 1*s*. 6*d*.

| Period | Bombay wholesale prices (Index Number) | United States of America gold prices (Index Number) | United Kingdom gold prices (Index Number) |
|---|---|---|---|
| July, 1925 | 158 | 160 | 157 |
| February, 1926.... | 152 | 155 | 149 |

(2) THE COURSE OF PRICES FROM DECEMBER, 1922 TO JUNE, 1925 :—He then examined the contention of the Majority that the fall in rupee prices in the first half of 1925 represents "the tendency of those to adjust themselves to the rise in exchange." The figures given by him are arranged in the following table :—

| Period | °/o gold parity of the rupee | World gold prices (Index Number) | Calcutta prices (Index Number) |
|---|---|---|---|
| December, 1922 | 95 | 156 | 176 |
| June, 1925 | 113 | 157 | 157 |

The figures show that the *adjustment of Indian prices to world prices was only partial till June, 1925.* Because, as gold parity rose 19 per cent. (from 95 to 113), the adjustment to be complete should have meant a corresponding fall of 19 per cent. in the Indian price level, *i. e.*, a fall of 33.5 points in the Calcutta Index Number. But the actual fall was of 19 points only (from 176 to 157).

(3) THE COURSE OF PRICES FROM JULY, 1922 TO FEBRUARY, 1926 :—He next took the whole range of price movements from July, 1922 to February, 1926.

| Period | °/o gold parity of the rupee | World price level (Index Number) | Calcutta price level (Index Number) | Average of Calcutta and Bombay (Index Number) [1] |
|---|---|---|---|---|
| July, 1922... | 90 | 155 | 181 | 185 |
| February, 1926... | 144 | 155 | 158 | 155 |

The conclusions drawn from the above table are that the world price level was exactly the same at the beginning and end of this period. And when there was an *increase of 27 per cent. in gold parity* of the rupee there was *a fall* in the Calcutta Index Number of *23 points.*

[1] The Calcutta Index Number fell 5.3 points, a figure which corresponded very closely with the fall in the Bombay Number and strengthened the same conclusion.

But on a 27 per cent. increase in gold parity of the rupee, a *fall of 49 points should have occurred* to bring about complete adjustment of the Indian to the world prices. Thus a fall of 26 points, or *more than half the adjustment was still to come in February, 1926.*

Taking the average of the Calcutta and Bombay Index Numbers we find a fall of only 30 points against 50 points (27 per cent. of 185) to be expected for full adjustment.

CONCLUSIONS :—Thus at the rate of 1*s.* 6*d.* per rupee, prices in India had *not* attained a substantial measure of adjustment with world prices, but the greater part of the *general adjustment* to *1s. 6d. by a fall, had still to come.*

**III. No adjustment of Wages to 1s. 6d. ratio.**

As regards Wages, Sir Purshotamdas concluded that *no adjustment* either in agricultural, industrial or clerical wages had taken place, and none would hereafter, without a struggle. He proved the truth of his statement by the help of statistics.

(a) *Agricultural Wages.* From the statement submitted by Mr. Ginnings of the Labour Bureau in Bombay, it was found that in the various divisions of the Bombay Presidency *the increase* in the wages of labour between 1913 and 1925 was as follows :—

| Areas | Class of labours | *Percentage Increase* |
|---|---|---|
| I Rural ... | Field ... ... ... | 106 |
| ,, ... | Ordinary ... ... | 86 |
| ,, ... | Skilled ... ... | 109 |
| II Urban ... | Field ... ... ... | 121 |
| ,, ... | Ordinary ... ... | 104 |
| ,, ... | Skilled ... ... | 116 |

In the absence of any other data, these figures he concluded, might be taken as representing the general agricultural wage level in India, there being no evidence of a decline in wages from any part of the country.

(b) *Industrial Wages*:—Regarding the industrial labour, the figures submitted were as follows :—

| Industry | Index number for 1914 | Index number for 1925 |
|---|---|---|
| Bombay Cotton Mill ... | 100 | 232 |
| Jute Mill ... ... ... | 100 | 150 |

From no part of India was there any suggestion that the industrial wages had a tendency to *fall*. Besides, increase in *wages lagged behind* the rise in prices since 1914. The variations in the Jute Mills in Bengal are shown as follows :—

| Date | Index Number of Calcutta wholesale prices (30th July, 1914=100) | Wages (1913=100) |
|---|---|---|
| May, 1918 ... | 173 | 110 |
| January, 1920 ... | 218 | 140 |
| April, 1925 ... | 169 | 150 |

This illustrates the very slight connection, over a considerable period of time, between variations in the cost of living and in wages. He also laid stress on the inability of the Industrial wage-earner to reconcile himself to any decrease in wage, even on the ground of the appreciation of the rupee in gold, as was proved by the strikes of the Bombay Mill-hands in 1923 and 1925.

Even with regard to the employees on the State railways there had been no reduction in wages. Thus, in the North Western Railway Locomotive Workshops at Lahore, the average increase in monthly wages of unskilled workmen in 1922 was 220, nor was it suggested by any official witness that the Government had contemplated any reduction in the wages of their employees on the ground of the appreciation of the rupee in relation to gold.

(c) *Clerical Wages* :—The official figures supplied with regard to wages of clerks, in the City of Bombay in 1924, showed a percentage increase of nearly 77 over 1914.

CONCLUSIONS :—The Indian cost of living index number in March, 1926, was 155. Any increase in this cost consequent on a reversion to the 1*s*. 6*d*. ratio (even assuming that adjustments to 1*s*. 6*d*. had fully taken place) would not exceed 12½ per cent., even then there would remain a *clear margin to cover*, as was shown by the figures of wages (except in the case of the labourer in the Jute Mills and mines in Bengal). "Besides, an adjustment in wages to the 1*s*. 6*d*. basis, if it has to be enforced, will therefore entail a long and bitter struggle between Labour and Capital, with consequent disturbance in the economic organisation of the country."

### IV. Effects on contracts.

Sir Purshotamdas next considered the effects on contracts. It had been urged that a change to 1*s*. 4*d*. would prejudicially affect the outstanding contracts of a short term character. He refuted the argument by considering the effect on various forms of contracts.

(a) *Commercial contracts* :—It was acknowledged that for all commercial transactions exchange could be *covered*

for a period of 12 months ahead. If a businessman kept his contract open, it would be his own fault. And particularly since 1924, when it was widely known that the statutory 2*s.* ratio was to be changed, no careful businessman could be justified in not covering his exchange.

(b) *Industrial and commercial borrowing* :—The industrial and commercial corporations borrowing over a period of 20 or 30 years, would not be prejudicially affected by having to meet obligations at the gold value of the rupee at 1*s.* 4*d.*, *if they entered in their obligations before 1917.* It was only those who borrowed since 1917, who would be affected by the ratio 1*s.* 4*d.* But these could not be very large. But after the War, for some time, fluctuations were unavoidable, and then the failure of the Government to maintain the 2*s.* ratio led to such serious fluctuations in the exchange that those, who made contracts during these years of fluctuations, were likely either to suffer or to gain by instituting *any* ratio at present.

(c) *Agricultural indebtedness* :—But the indebtedness of the Indian Agriculturist and the masses demanded serious consideration. Mr. M. L. Darling, I. C. S. of the Punjab, estimated the rural indebtedness of British India at Rs. 600 crores. It was probably Rs. 200 crores for Indian States. As the rate of exchange between 1900 and 1917 was round 1*s.* 4*d.*, it was only right to assume that most of this debt of Rs. 800 crores was contracted when the rupee was 1*s.* 4*d.* gold. Now to fix the exchange at 1*s.* 6*d.* gold would practically mean putting a burden of 12½ per cent. on these borrowers. This is a class whose case should have the first consideration in dealing with the effects of 1*s.* 6*d.* ratio.

Under the heading of contracts, therefore, "the higher

figure of 1s. 6d. has little to recommend it, and very much against it."

### V. Effect on Finance of the Central Government.

The most serious item to be considered was the alleged gain from 1s. 6d. of Rs. 3.16 crores in the General Budget (Railway Budget is separated from it). As against this, there was to be put an increase of Rs. 2.62 crores in customs on stabilization at 1s. 4d. Besides, account must be taken of the decrease under bounties to certain industries given on the rise of exchange to 1s. 6d., so also an increase in receipts under Income-Tax and Corporation Tax, owing to industries being spared the disturbance incidental to 1s. 6d., bearing in mind that Joint Stock companies pay very nearly 15 per cent. out of their profits under Income Tax and Corporation Tax.

This clearly showed that the claim of a gain by 1s. 6d. was exaggerated. However this unearned increment in the Government of India Revenue Budget would exist as a tangible and visible asset only during the period of non-adjustment, and would vanish when adjustment was complete. Moreover, during the period of non-adjustment, while there was a tangible gain to the exchequer, some one paid for it—"*It is the producer who has to accept so many fewer rupees for the produce he has to sell.*"[1]

### VI. Larger resources necessary to maintain 1s. 6d. ratio.

The question to be decided was whether it was necessary to fix a ratio that would require larger resources to maintain, if the fixing of the ratio could be avoided. A little lull in the export trade from March, 1926, necessi-

[1] Sir Purshotamdas quoted the words of Mr. Robert Campbell and Sir John Muir in their supplementary note in the Fowler Committee Report.

tated resort to deflation in India to the extent of Rs. 8 crores to maintain the exchange, and to the offer of sale of the Reverse Councils at 1*s*. 5¾*d*. That was enough evidence to prove that larger resources would have to be required to maintain the ratio.

### VII. Alleged Effect of Reversion to 1s. 4d.

The Majority apprehended that a reversion to the 1*s*. 4*d*. ratio would lead to a rise in price to the full extent of 12½ per cent. of articles given and consumed in India, and as a consequence, hit the poorer members of the literate class and consumers generally, because prices had substantially adjusted themselves to the 1*s*. 6*d*. rate.

To this the answer given by Sir Purshotamdas was that he had conclusively proved that no adjustment of prices to 1*s*. 6*d*. ratio had taken place, and that the major part of it was still to come. Hence, any disturbance that might ensue from the fixation of the lower ratio would produce a very insignificant disturbance in economic conditions, injurious to but a few, if any at all. "Besides, as regards the burden likely to be imposed, if 79 per cent. of the people of India subsist on agriculture, it is difficult to understand the concentration of my colleagues on the interests of the other 21 per cent. who live on the production of this class."

### VIII. Claim of the debtor Class.

Besides, a change to 1*s*. 6*d*. would hit the large bulk of the *debtor class,* to the benefit of the creditor class. He stated, "I cannot conceive of any valid or moral reasons for a step calculated to give the latter an unearned increment at the expense of the former. In India, perhaps more than anywhere else, the debtor class is the largest and the neediest, for whom the Government has

always evinced concern and solicitude. What unavoidable reason, then, is there to hit *this* class?''

**IX. Suitability of the 1s. 4d. ratio.**

*Finally, 1s. 4d. was the ratio that stood for 20 years,* even during the American Crisis, till 1917, and was only disturbed as a result of the War in common with the ratios of other countries in the world. It could not lightly be said to be a ratio that was unnatural to the Indian system. No other country had adopted a rate of exchange higher than its pre-war rate. Even Great Britain did not change her standard when the £ sterling dropped to 3.38. Other countries had made great sacrifices to return to their pre-war ratios, which was the proof of the sanctity attaching to them. ''But in India, it is not a question of making a great sacrifice to regain her 'permanent rate'. It is, at worst, a question of balancing the disturbance which may be caused by a reversion to 1*s*. 4*d*., and an adoption of 1*s*. 6*d*.''

# CHAPTER VII.

## The Currency Act, 1927.

***Fixation of the 1s. 6d. ratio and imposition of a statutory obligation upon the Currency Authority to purchase gold and sell gold or sterling.***

TRANSITIONAL MEASURES ADOPTED :— The first fruits of the Report of the Hilton-Young Commission was the passing of the Currency Act, 1927. This Act embodied merely those measures which the Commission recommended for the *transitional period*. It is purely an interim measure which was intended to cover a period between the time when the Act was passed (April, 1927) and the time when the "Gold Standard and Reserve Bank of India" Bill, which was placed before the Legislative Assembly was expected to come into effect. But this Bill had a chequered history and having passed through nearly five stages in its career was ultimately dropped on 13th February, 1928.[1]

The Currency Act, 1927, therefore still exists as a *transitional measure*. It does *not* touch the question of the Gold Bullion Standard at all. In the words of Sir Basil Blackett, the late Finance Member, "It does not do anything more than provide for an interim period during which the standard will be a gold exchange standard."[2]

The clauses of the Act are very technical in form but in substance they are as follows :—

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1 The history of the Gold Standard and Reserve Bank of India Bill is fully traced in the Author's: *A Reserve Bank for India and the Money Market*, Chapter XV.

2 Legislative Assembly Debates, Vol. IX—No. 35, page 2110.

I. THE RATIO FIXED AT *1s. 6d.* :—In the first place, it has amended the Indian Paper Currency Act, 1923. Under this Act the rupee was valued at 11.30016 grains of gold *i. e.* it corresponded to a rate of exchange of *2s.* for the rupee. But the Currency Act of 1927 has altered this value to 8.47512 grains of gold per rupee, *i. e.* the *exchange value of the rupee has been fixed at 1s. 6d.*[1]

II. SOVEREIGN AND HALF-SOVEREIGN NO LONGER LEGAL TENDER :—In the second place, under the Indian Coinage Act, 1906, and the Indian Paper Currency Act, 1923, the sovereign and half-sovereign were legal tender at the rate of Rs. 10 per sovereign.

But the Currency Act, 1927, *has taken away the legal tender character of the sovereign and half-sovereign in India altogether.* This was done in accordance with the recommendation of the Royal Commissioners who wrote that the sovereign and the half-sovereign should be demonetized in order to enable the new gold bullion standard to come into force. In supporting this argument in the Legislative Assembly Sir Basil Blackett said, "It is quite a different thing to take away the legal tender character from a coin which is not in fact in actual circulation at all, which has not circulated for some years. It is quite another thing, after having given it a legal tender character

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1 Considering the scope of this volume an apology from the Author will, it is hoped, be readily accepted by the reader, for not having included in it an account of the various arguments for and against the *1s. 6d.* ratio which were put forward by the Legislators before the Legislative Assembly when the Bill was being discussed. But most of these arguments arrayed were deductions from those principally stated by the Majority and the Minority of the Royal Commission of 1926, and on 8th March, 1927, an amendment to fix the ratio at *1s.—4d.* (instead of *1s.—6d.*) was lost by 65 votes against 68.

For a full account reference is made to *Legislative Assembly Debates,* Vol. VIII—Nos., 2 and 5; Vol. IX—Nos., 30, 31, 36, 38, 39, 40.

now, to take away that legal tender character 5 or 6 months hence. The matter is perfectly open to the House to decide in connection with the Gold Standard and the Reserve Bank Bill".[1] On this ground then the sovereign and half-sovereign have been demonetized.

III. STATUTORY OBLIGATION TO PURCHASE GOLD AND SELL GOLD OR STERLING :—In the third place, the Currency Act, 1927, has imposed *for the first time* on the Government (the currency authority) *a statutory obligation* :

(a) to *purchase* gold bullion tendered by the public for sale in the form of bars containing *not less than forty tolas* of fine gold at the rate of Rs. 21-3-10 per tola of fine gold (*i. e. at* 1s. 6*d.*=Re. 1);

(b) (1) *to sell* to any person who makes a demand in that behalf, *gold* for delivery at the Bombay Mint at the rate of Rs. 21-3-10 per tola of fine gold *or, at the option* of the Controller or the Deputy-Controller, as the case may be, sterling for immediate delivery in London at an equivalent rate:

Provided that no person shall be entitled to demand an amount of *gold* or *sterling* of less value than that of *1,065 tolas* of fine gold.

(2) For the *purpose of determining the equivalent rate applicable to the sale of sterling* the Act states that Rs. 21-3-10 shall be deemed equivalent to such sum in sterling as is required to purchase 1 tola of fine gold in London at the rate at which the Bank of England is bound by law to give sterling in exchange for gold, after deduction therefrom of an amount representing the normal cost per tola of transferring gold bullion in bulk from Bombay to London, including interest on its value during transit. This rate was to be determined by the Governor-General-in-Council from time to time and notified accordingly.

This clause needs some interpretation. It has, as stated above, *for the first time* placed a statutory obligation on the Government of India (so long as it remained the Currency Authority), to buy gold at the fixed parity

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[1] Legislative Assembly Debates, Vol. IX—No. 38, page 2394.

of the rupee and to sell gold or *sterling* at their option at the upper and lower gold points corresponding to that fixed parity. It may be recalled that in the system as it existed before this Act came into operation, the provision requiring the Government to give rupees in exchange for gold operated to prevent the exchange rising above the fixed rate. But there was *no statutory obligation on the Government to prevent the rupee falling below the fixed rate,* so that the link between the rupee and gold was imperfect. And it was left to the discretion of the Government to take any steps, such as the sale of the Reverse Councils, to prevent the rate falling.

By the Act this discretion is no longer possible and it will no longer be *within the power of the currency authority to let exchange stray away from the fixed rate* "without coming within the mischief of statutory provisions of an Act of the Indian Legislature."[1] The Royal Commission laid great stress on this part of their recommendation and wrote : "We desire expressly to emphasize that this recommendation as to the transition period is of the essence of our proposals. The Government of India should at once publicly announce its acceptance of the obligation as defined and should fulfil it without variation during the period of transition. We are of opinion that this obligation should be embodied in a statutory form".[2]

Thus the statutory enforcement of this obligation to maintain the rupee within its fixed upper and lower points is the essence of this Act. And this statutory obligation on the Currency Authority to *purchase gold* but *sell gold or sterling at their option* at fixed rates in order to maintain the exchange value of the rupee, establishes the

1 Sir Basil Blackett in his speech before the Legislative Assembly.
2 Paragraph 166 of the Report.

*gold or sterling exchange standard on a firmer basis during the transition period.*

Another part of this clause needing an explanation is that concerning the actual quantity of gold which the Act compels the Currency Authority to purchase and sell. The minimum quantity of gold which it could *purchase* when offered to it for sale by the public is fixed at 40 tolas (or 15 ounces) instead of 1065 tolas (or 400 ounces) as recommended by the Royal Commission. This was done to enable the poor people and the petty merchants to avail themselves of the system, as the quantity so reduced would be within their easy reach. The quantity 1065 tolas was too heavy, regard being had to the circumstances and conditions obtaining in India.

But the quantity of gold or sterling which the Currency Authority shall *sell* is fixed at 1065 tolas. This is done, in accordance with the recommendation of the Royal Commission, to prevent gold from being demanded by the public for non-monetary purposes. And the *option given to the Currency Authority to give gold or sterling makes the standard a gold or sterling exchange standard.*

### SUMMARY

By the Currency Act, 1927, which is still in force :

(1) the rate of exchange is fixed at 1*s.* 6*d.*;

(2) the sovereign and half-sovereign have been demonetized ;

(3) a statutory obligation is imposed on the Currency Authority for the first time to *purchase gold* and *sell gold or sterling* to the public when demanded by them. Thus the gold or sterling exchange standard has continued to exist.

# CHAPTER VIII.

## Indian Currency and Exchange during 1927-1931.

### Principal World Factors affecting India's economic condition.

The four years which have followed the passing of the Currency Act of 1927 can, in common with other countries of the world, be divided into two almost clearly marked periods: (A) During the first two years and a half *ending with September, 1929,* there was a general improvement in economic conditions in most countries of the world, although during the last four months depression in world trade had already begun.

(B) But the period following September, 1929, has been one of a *monotonous fall in general prices and of an unprecedented depression in industry and trade.*

It is therefore relevant to give a survey of the principal world factors which have contributed to affect the economics of India.

(A) During the official years 1927-28 and 1928-29 there was a movement of European Governments towards the stabilization of their currency systems. Thus, Italy returned to the gold standard and the French Government, in order to stabilize the French exchange, fixed the legal value of the franc. These factors tended to remove serious obstacles to the rehabilitation of the trade of Europe. Great Britain emerged from the depressing effects of the prolonged coal strike of 1926-27 and the prospects of her trade and industry improved. In November, 1928, a currency reform of great importance took place in England. The notes issued by the British Treasury and the Bank of England were amalgamated.

These measures, combined as they were with provisions for increasing the centralization of the various national currency reserves, brought the monetary systems of the world into still closer contact and paved the way towards trade prosperity.

On the other hand, in Japan there was a severe banking crisis in April, 1927, which necessitated the declaration of a moratorium by the Japanese Government, and although financially the country made considerable progress towards rehabilitation during the following year, the stability of the Yen was not attained. These factors affected India principally by their reactions on cotton exports and on silver prices.

Further, the steps taken by the currency authorities in the United States of America to control the expansion of credit in that country had wide international repercussions. In July, 1928, the federal reserve discount rates were raised and other measures were also taken to make credit dear, which gradually began to attract short-term money from other world centres to the United States for investment. To prevent this drain of money to the United States and to protect the exchange there was a general world movement throughout the year towards higher bank rates :

(B) This movement continued during the greater part of 1929, and during this and the succeeding year, world finance, commerce and industry were chiefly influenced by *the speculation in the stock exchanges of the United States of America,* and the measures taken by the Federal Reserve Board to curb it.

But this boom broke in the United States at the end of October, shortly preceded by a collapse of a similar though less violent boom on the British Stock exchanges.

These gave a terrible shock to world's commercial activity, and the consequent reluctance to manufacture or buy, brought about *a large drop in the wholesale prices of commodities.* This tendency was aggravated by the large withdrawals of gold by certain European countries, principally France and Germany into their currency reserves. The general fall in wholesale prices continued uninterruptedly up to March, 1931, and had catastrophic effects on world trade.

The extent of this fall can be seen in Statement I.

***Statement I. Index Numbers of wholesale prices.***

| | India | | United Kingdom | United State of America |
|---|---|---|---|---|
| | Calcutta (a) | Bombay (b) | (c) | (d) |
| 1928, April | 146 | 142 | 143 | 97 |
| 1929, March | 143 | 147 | 140 | 98 |
| *1929, September* | *143* | *147* | *136* | *98* |
| 1930, March | 125 | 137 | 125 | 91 |
| 1930, September | 111 | 120 | 116 | 84 |
| 1931, March | 100 | 111 | 106 | 75 |

(a) Indian Trade Journal, 1914. Basis 100.
(b) Bombay Labour Gazette, 1914. Basis 100.
(c) Board of Trade, 1914. Basis 100.
(d) Bureau of Labour Statistics, 1926. Basis 100.

One of the most remarkable features of the collapse of the speculation boom in the stock exchanges of the United States was the effect on rates of discount ruling in the three most important international money markets. The Federal Reserve Bank rediscount rate reached the lowest level of 2 per cent. on the 23rd December, 1931, and the Bank of France rate was reduced from time to time until it reached 2 per cent. from the 2nd January, 1931. The

Bank of England rate too was reduced to 3 per cent. on 1st May, 1930, and remained at that figure throughout the rest of the year.

Two other important events during 1930-31 which had repercussions on world finance were, the large number of bank suspensions in the United States and the so-called Oustric collapse in France. Both of these tended to retard a return of confidence. The Oustric affair led to a large repatriation of foreign investments and as a consequence heavy withdrawals of gold from London and America on French account. Thus, during the year the gold holding of the Bank of France increased from 42,557 million francs to 56,116 million francs. Japan too suffered as much as other countries from a fall in the price level, unemployment and a heavy decline in exports.

### I. Indian foreign trade and exchange.

(A) DURING 1927-28 AND 1928-29 :—In India during the two years there was a general improvement in economic conditions. The only disquieting feature in 1928 was the strikes in the cotton mill and steel industries which continued until the cold weather. But for this, the trade and commercial conditions in this year would have been more favourable than in preceding years. The monsoons were on the whole good, crops were large and foreign demand for the export staples was also good leading to a steady increase in the value of exports as shown in Statement II.

***Statement II. Balance of Trade in private merchandise.***
*(in lakhs of rupees)*

| | 1926-27 | 1927-28 | 1928-29 | 1929-30 | 1930-31 |
|---|---|---|---|---|---|
| Exports | +3,01,43 | +3,19,11 | +3,30,13 | +3,10,80 | +2,20,46 |
| Re-exports (of foreign merchandise) | + 8,01 | + 9,54 | + 7,83 | + 7,13 | + 5,14 |
| Imports | -2,29,98 | -2,46,78 | -2,51,49 | -2,38,95 | -1,63,62 |
| Balance of Trade | +79,46 | +81,87 | +86,47 | +78,98 | + 61,98 |

The result of the increase in the value of exports was greater strength in exchange which actually reached the upper gold point in December, 1927, and in January and November, 1928. The Government could therefore with ease make remittances by the new method of purchasing sterling by public tender in India. The sterling purchased in India by the Government during 1927-28 was to the amount of £28,325,000 and in 1928-29 it was worth £30,810,000.

But these remittances were insufficient to meet the requirements of the Secretary of State and had to be supplemented by such means as (1) drawings on the sterling reserves, (2) issue of India Bills in London, (3) issue of sterling loans in London, (4) issue of Treasury Bills in India in large amounts.

(B) DURING 1929-30 AND 1930-31 :—India being a country where general economic well-being is still very dependent on the world demand for her agricultural produce, could not hope to escape the serious effects of the world factors narrated above. Although the monsoon

was adequate and harvests good during the two years the collapse in world prices and the world depression in trade influenced Indian Exports considerably as is shown in Statement II. The effect of the civil disobedience campaign cannot be ignored in this connection.

EXCHANGE DURING 1929-30 :—The reaction of these factors on Indian exchange was inevitable. It was generally weak and the Government had considerable difficulties in purchasing sterling to make remittances to the Secretary of State. For several weeks no tenders were made at all.

Therefore, Treasury Bills had to be issued continuously and contraction of currency had to be brought about at certain times, in order to tighten up money. "The issue of Treasury Bills enabled the Government not only to maintain the exchange value of the rupee without selling gold or sterling but to purchase a fair amount of remittance towards meeting the requirements of the Secretary of State".[1] These factors, combined with the rise of the Imperial Bank of India rate to 7 per cent., in October, enabled the Government to make good purchases.

But with the sudden and heavy fall in the prices of commodities consequent on the collapse of the stock exchange boom in New York the Government's difficulties in purchasing sterling increased and they were compelled to pay a high price for sterling and generous rates for selling Treasury Bills. But the exchange continued to remain weak at 1*s.* 5$\frac{13}{16}$*d.*, throughout March, 1930. In all the Government was able to purchase sterling to the amount of £15,215,000, and a further £11,825,000 was transferred to the treasury balances of the Secretary of State in London against an equivalent contraction of currency.

[1] Report of the Controller of the Currency, 1929-30, page 3.

In order to meet the Secretary of State's further requirements of £18 millions, sterling bills and a sterling loan had to be floated in London.

EXCHANGE DURING 1930-31 :—Up to July, 1930, although the exchange recovered from time to time, it became definitely weak from that month to October. The highest rate touched in August and September was 1*s.* $5\frac{25}{32}$ *d.* and the lowest 1*s.* $5\frac{3}{4}$*d.*, notwithstanding that "Treasury bills were sold freely throughout this period and contractions to the extent of Rs. 20 crores were made against rupee securities".[1] And purchase of sterling became very difficult. At this time the civil disobedience movement was in full swing and business was paralysed.

On the 19th November no tenders were received by the Government who had to announce their withdrawal from the market for the time being. The middle of November saw the beginning of a distinct change for the worse. A period of consistent weakness set in which lasted until the end of February and the Government was unable to purchase sterling during these months.[2]

On the contrary, "a demand arose *for the sale of sterling* by the Government at the statutory rate of 1*s.* $5\frac{49}{64}$ *d.* The market was governed practically in toto by the political situation throughout this period and the amount of sterling sold between November and March totalled £5,650,000." But when the political situation was eased exchange began to gain strength and reached 1*s.* $5\frac{7}{8}$ *d.* in the end of March.

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[1] Report of the Controller of the Currency, 1930-31, page 13.

[2] This was partly due to the fact that rumours were fully circulated to the effect that one of the recommendations made to the Round Table Conference which was to meet on the 12th November was that a remission would be made to the old statutory 1*s.* 4*d.* ratio—Report of the Controller of the Currency, 1930-31, page 14.

During the year 1930-31 sterling to the amount of only £5,395,000 was purchased through the market. It was, therefore, necessary to meet the Secretary of State's requirements by other means, such as remittance through the Paper Currency Reserve or by borrowing in London. Sterling loans to the extent of £31 millions had to be raised in London. *And the entire holding of the Paper Currency Reserve in England including sterling securities were transferred to the Home Treasury primarily to meet sales of sterling againgst corresponding contraction of rupees in India.*[1]

**II. Contractions of the Currency, sales of Treasury bills and Money Rates.**

The monetary situation in the United States of America, particularly after the collapse of the speculation boom in the country in September, 1929, actually affected money rates in the world. As stated previously, contraction in the demand for money caused by the prevailing low prices, stagnant stock markets, smaller borrowings by traders, and the nervousness of the banks for loaning money resulted in a marked decline in discount rates as shown in Statement III.

***Statement III. Bank rate %***

| | 1927 (end of December) | 1928 (end of December) | 1929 (end of December) | 1930 (end of December) | 1931 (14th February) |
|---|---|---|---|---|---|
| London | 4½ | 4½ | 5 | 3 | 3 |
| New York | 3½ | 5 | 4½ | 2 | 2 |
| Calcutta | 7 | 7 | 7 | 6 | 7 |

[1] Report of the Controller of the Currency, 1930-31, page 14. See also Chapter IX, Period VII.

Statement III shows a well marked difference between the Calcutta Bank rates and those in London and New York, the former being considerably higher than those in the latter countries. The reasons for this marked disparity are given by the Controller of the Currency who stated : "low money rates in highly developed industrial countries do not necessarily imply a similar state of affairs in agricultural countries whose staple trade consists in the export of the raw materials of commerce. Given satisfactory harvests in such countries prices of agricultural products are the first to fall resulting in redundancy of floating money, disequilibrium of prices, and an undue strain on the foreign exchanges. It is clearly necessary in such circumstances to take measures to ration credit and to control money rates until equilibrium is restored." [1]

Under the circumstances during 1929-30 and 1930-31 the Government of India had to take measures to control the short money market and to withdraw redundant funds by (1) continuous issues of Treasury bills and (2) contractions of the currency. The Bank rate of the Imperial Bank of India had to be raised from time to time. Statement IV shows the effort towards steadying the rates.

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1 Report for the year 1930-31, page 2.

**Statement IV. The Bank rate of the Imperial Bank of India.**

*(Per cent.)*

| | 1927-28 | 1928-29 | 1929-30 | 1930-31 |
|---|---|---|---|---|
| April | 7 | 7 | 8 | 6 |
| May | 7 | 7 | 7 | 6 |
| June | 7 | 7 | 6 | 6 |
| July | 5 | 6 | 5 | 6 |
| August | 4 | 5 | 5 | 5 |
| September | 4 | 5 | 5 | 5 |
| October | 5 | 5 | 5 | 5 |
| November | 5 | 5 | 7 | 5 |
| December | 5 | 6 | 7 | 6 |
| January | 7 | 7 | 7 | 6 |
| February | 7 | 7 | 7 | 7 |
| March | 7 | 8 | 7 | 7 |

The extent of the contractions of the currency brought about during the last four years can be judged from Statement V.

**Statement V. Total Expansions and Contractions of Currency during the period 1926-27 to 1930-31.**

**Expansions + or Contractions—**

*(in lakhs of rupees)*

| 1926-27 | 1927-28 | 1928-29 | 1929-30 | 1930-31 |
|---|---|---|---|---|
| —29,25 | —4,10 | +1,90 | —32,41 | —38,64 |

During the last two official years there began a serious *outflow of capital from India* due chiefly to three causes : (1) the seasonal weakness of the demand for money, (2) the more important tendency created by the political situation of the country to sell investments in India and take the proceeds out of the country and (3) the tendency on the part of cautious investors to spread their risk by investing part of their capital abroad. To prevent the outflow of funds during these years large amounts had to be withdrawn from the market and the means adopted to do so was the continuous issue of Treasury bills.[1]

Generally, it is the sales of the Treasury bills that dominated the Indian Money Market particularly during the last two years. The extent of the total sales of 3, 6 and 9 months' Treasury bills and Intermediates sold during the four years will be judged from Statement VI which also shows the extent of the financial difficulties of the Government of India.

***Statement VI. Total Sales of Treasury bills.***

*(in lakhs of rupees)*

| | Total of 3, 6 and 9 months' bills | Intermediates |
|---|---|---|
| 1927-28 | 25,86 | 4,50 |
| 1928-29 | 20,55 | 1,87 |
| 1929-30 | 44,73 | 20,00 |
| 1930-31 | 69,11 | 89,91 |

Every sale of Treasury bills should ordinarily result in a contraction of the currency. But it is difficult, in the absence of statistical data, to prove how much *net* contraction must have resulted from these sales, because the

[1] Report of the Controller of the Currency, 1929-30, page 3.

sale of such bills on a particular day may have been executed to pay off the old bills on their reaching maturity. Thus, suppose 3 months' Treasury bills to the amount of Rs. 1 crore were sold on the 1st of September; and Treasury Bills worth Rs. 2 crores are sold on the 1st December. Then bills worth Rs. 1 crore may have been sold to meet those issued on 1st September. If this is the case, there would be a contraction of the currency of Rs. 2 crores and an expansion of the currency to the extent of Rs. 1 crore, resulting in a net contraction of Rs. 1 crore.

But the fact that during 1929-30 for nearly 197 days of the year and during 1930-31 for nearly 247 days of the year Treasury bills were sold designates the important part these bills played in controlling money rates. Statement VII shows the total of Treasury bills outstanding at the end of the month of each year.

**Statement VII. Treasury bills outstanding.**

*(in iakhs of rupees)*

| At the end of each month | Amount |
|---|---|
| April, 1928 | 12,17 |
| March, 1929 | 3,99 |
| September, 1929 | 26,78 |
| March, 1930 | 36,03 |
| September, 1930 | 49,06 |
| March, 1931 | 55,37 |

### III. Continuous and Heavy Fall in the Price of Silver.

Another noticeable feature of these years was the almost uninterrupted and heavy fall in the price of silver.

The predominant factor in influencing the price of this metal was the situation in China. The remarkable firmness of price in 1928-29 was due to the continued absorption of the metal by China, but towards the close of the year the large increase in stocks in Shanghai was already beginning to exercise a depressing effect, which steadily increased throughout the year. Since then there was a continuous downward movement which is shown in Statement VIII.

***Statement VIII. Price of Silver.***

| | Price in Bombay per 100 tolas (country bar) Lowest | | Prices in London per standard oz. Lowest |
|---|---|---|---|
| | Rs. | As. | *d.* |
| April, 1928 | 58 | 13 | $26\frac{1}{4}$ |
| April, 1929 | 56 | 12 | $25\frac{3}{16}$ |
| *September, 1929* | 52 | 12 | $23\frac{3}{16}$ |
| April, 1930 | 52 | 15 | $19\frac{3}{16}$ |
| September, 1930 | 46 | 4 | $16\frac{7}{16}$ |
| March, 1931 | 41 | 5 | $12\frac{5}{8}$ |

The fall in silver during 1930-31 was more pronounced than ever for three principal reasons : (1) the main cause was the happenings in China. Owing to the fact that that country has been subject to political disturbance and warfare for several years past, its exports have declined, and in order to pay for imports, large amounts of silver had to be sold. The effect on the world price was necessarily great. (2) Secondly, silver was bound to share

in the general fall of prices of all commodities which took place during the year. (3) Thirdly, since the conditions of silver production are peculiar and the metal is very largely a by-product, a fall in its price does not necessarily bring about a corresponding decline in production. In fact, statistics show that the production of silver during 1930 was 241 million fine ounces as compared with 261 millions in 1929 and 258 million in 1928.

**IV. Sales of Silver by the Government of India and import duty on Silver.**

Consideration must also be given to the fact that during the four years the Government of India sold silver from the Paper Currency Reserve. The Hilton-Young Commission found the silver holding unduly large, and recommended its gradual reduction from Rs. 85 crores to Rs. 25 crores during the transition period of 10 years, and stated that "no favourable opportunity of fortifying the gold holding in the Reserve should be allowed to escape". Following up this recommendation the Government of India sold silver from time to time until from the commencement of their operations in 1927 the total sales amounted approximately to *101 million fine ounces* by the end of 1930-31. With the price of silver persistently falling, loss must have been incurred by these sales. In the absence of any statistical data it is difficult to estimate the loss.

With regard to the import duty on silver it may be noted that the Budget of 1930-31 announced its re-imposition in spite of its discontinuance after the War. The rate was four annas an ounce and an excise of the same amount was imposed on silver mined in India. The Budget for 1931-32 announced an increase in the import duty on silver from 4 annas an ounce to 6 annas an ounce.

# BOOK III

# CHAPTER IX.

## History of Indian Paper Currency.

- Period I. — Before 1862.
- Period II. — 1862-1914.
- Period III. — 1914-1919. [during the war.]
- Period IV. — Recommendations of Babington-Smith Committee.
- Period V. — 1920-1925.
- Period VI. — Report of Hilton-Young Commission.
- Period VII. — 1927-1931.

## PERIOD I -- History before 1862.

BANK PAPER MONEY :—There was no issue of Government Paper Currency before 1862. The Presidency Banks of Bombay, Bengal and Madras were given authority to issue notes by various Acts.[1] These banks were known as 'Chartered Banks' and were controlled by the Government. People were not familiar with the use of paper currency and communications were very difficult in those days ; therefore, the notes of the Banks had a very restricted circulation. The legal limit put to the issue of notes of all the Banks was Rs. 5 crores in all.

The Government Paper Currency System of India dates from 1862, in which year the notes of the Presidency Banks were withdrawn and a Government monopoly of Note issue was established.

MR. WILSON'S SCHEME, 1859 :—The first definite scheme for a Government Paper Currency was put forward by Mr. James Wilson, the first Finance Member of the Government of India. He recommended :—

(1) The issue of Government notes which were to be maintained by a fixed proportion of silver coins to the amount of notes in circulation. The metallic portion of the Reserve was to be in silver coins which was to be *one-third* of the notes in circulation and the rest was to be invested in Government securities.

(2) The division of the country into large number of circles.

He, in fact, was in favour of the *Banking Principle* of note issue, which would give elasticity to the system.

But, before the scheme could be considered, Mr. Wil-

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[1] "And by other banks, known as Agency Houses that did a banking, in addition to a mercantile business". Findlay Shirras: *Indian Finance and Banking*, page 236.

son died, and his successor, Mr. Samuel Laing, was influenced by the principle of *absolute security* of note issue, which was enforced on the Bank of England by the Act of 1844. The Secretary of State endorsed these views and the Act of 1861 was passed, based on this principle.

THE PAPER CURRENCY ACT OF 1861 :—The main provisions of the Act of 1861 were as follows :—

(1) The issue of Paper Currency by the Government.
(2) A reserve of coin or bullion *against the whole of the notes, except an amount not exceeding Rs. 4 crores which was to be invested in Government Securities.*
(3) The lowest denomination was to be Rs. 10.
(4) For the purpose of the note system India was divided into three or more circles with each Presidency town as the centre of issue.
(5) Notes were to be legal tender in their circles for all payments, except by Government at offices and agencies of issue.
(6) Notes were to be issued against silver coins of the Government, and provision was made for issuing them against gold coin of the Government of India and against foreign gold coin or bullion.

THE CURRENCY PRINCIPLE OF NOTE ISSUE :—Consequently, the Indian system of note issue was avowedly modelled on that of the Bank of England as regulated by the Bank Charter Act of 1844, and its chief features remained unaltered up to 1914. In short, the system was based *on the Currency Principle of note issue*—absolute convertibility at the expense of elasticity.

## PERIOD II—Development of Paper Currency up to 1914.

But with the spread of education and confidence and familiarity with the use of notes, paper currency began to lose its rigidity.

GROSS CIRCULATION OF NOTES :—In the beginning the gross circulation of notes was slow, but the

increase became rapid after 1890, as is shown in the following table :—

*(In crores of rupees.)*

| Average of year | Gross circulation of notes |
|---|---|
| 1862-3 | 3·69 |
| 1890-1 | 15·77 |
| 1900-1 | 28·88 |
| 1906-7 | 45·14 |
| 1911-12 | 57·37 |
| 1912-13 | 65·62 |

**The changes in the system.**

It will be seen that the circulation increased rapidly after 1890. The factors that contributed to it were the changes made in the system.

(1) 5-RUPEE NOTE :—In the first place, a note of smaller denomination was introduced in 1891. It was the 5-rupee note. It became suitable in payment of small sums.

(2) UNIVERSALIZATION OF THE SYSTEM :—Then, so long as the notes were legal tender only within the circle of their issue, they had a limited circulation. But with the steady *universalization* of the notes the circulation increased. In 1903 the 5-rupee note was made legal tender throughout India except in Burma. And in 1910 notes of the denomination of 5, 10, 50 and 100 rupees were universalized. At the same time the number of circles was reduced.

**Developments in the Paper Currency Reserve.**

(1) THE INCREASE IN FIDUCIARY PORTION :—The changes were also slowly made in the Paper Currency Reserve. The first change made was in the *invested (fiduciary) portion of the Reserve,* as shown below :

*(In crores of rupees.)*

| Year | Additions made to invested portion of the Reserve |
|---|---|
| 1871 | 2 |
| 1891 | 1 |
| 1892 | 1 |
| 1897 | 2 |
| 1905 | 2 |
| 1911 | 2 |

Adding to these increases Rs. 4 crores already invested by the Act of 1861, the total invested portion increased to Rs. 14 crores ; of these Rs. 2 crores were invested in sterling securities in 1905 and another Rs. 2 crores in 1911.

(2) NEW FUNCTIONS OF THE PAPER CURRENCY RESERVE :—Before the closing of the Mints to the free coinage of silver in 1893, the Paper Currency Reserve was held in silver coins.

(a) But by the Act of 1893 currency notes were issued in exchange for gold coin or bullion to any amount.

(b) We also saw, in a previous chapter (page 49), that, by the Gold Note Act of 1898, the Government of India

was authorized to issue notes in India against gold deposited *in London* with the Secretary of State. This was intended as a temporary measure to remove the stringency in the money market. But it proved to be so useful that in 1902 the Act was made permanent, and the gold in England was utilized in buying silver for India. Finally, the Act of 1905 gave authority to the Government to hold the Reserve in rupees, gold coin and bullion and securities *either in India or in London*. Thus, by these Acts council drafts began to be sold by the Secretary of State for gold in London against the issue of notes to an equivalent amount in India, and this mechanism came to be used *in support of exchange* (see pages 74-75).

Thus, since 1905 the Paper Currency Reserve held in London served a twofold purpose. It came to be used (i) in buying silver for India and (ii) to support exchange when the balance of trade went against India.

(c) We saw in another chapter (page 74) why gold in the Paper Currency Reserve in India was diverted to London to the extent of £5,000,000.

ITS COMPOSITION ON 31ST MARCH, 1913 :- The composition of the Reserve on the 31st March, 1913, was as follows :—

*(In crores of rupees.)*

| Total circulation | Silver in India | Gold in India | Gold in London | Securities | |
|---|---|---|---|---|---|
| | | | | Rupee | Sterling |
| 68·97 | 16·45 | 29·37 | 9·15 | 10 | 4 |

From this table we find that the Securities amounted to a little over 20 per cent. of the total reserve. This was a much lower percentage than was usual in earlier years, because at the end of 1896-7 it was 42.1 per cent. ; at the end of 1905-6 it was 26.9 per cent.

#### Findings of the Chamberlain Commission.

Such was the situation when the Chamberlain Commission was appointed to examine the whole currency system of India.

(A) EXISTING SYSTEM INCONVENIENT :— In the first place, the Majority of the Commission took account of the Paper Currency System as it existed in March, 1913. They pointed out that India needed a more *elastic currency* for her increasing trade and commerce.

Unlike England, conditions in India, at all events outside the Presidency towns, did not favour any great extension of the cheque system or of credit instruments generally, and metallic currency and notes of small denominations remained the favourite and the only suitable currency medium with the vast majority of the people.

Therefore, the restrictions imposed upon the note issue system by the requirement of a metallic backing for all notes issued above a fixed minimum, which can only be altered by a specific Act of the Legislature, had become increasingly inconvenient.

Some elasticity was introduced by the Gold Note Act of 1898, and the development of the system of sale of the Council Drafts under which it was possible for notes to be issued in India against money tendered to the Secretary of State in London. But this elasticity was secured, they said, ''by the ear-marking of gold in London, which

is equivalent to the export of gold from London to India ; the expansion of currency of India is thus at the expense of the gold reserves of London, and in some circumstances the resulting stringency in London is so disadvantageous to India as to make an expansion of the currency by this means actually undesirable.''

The Majority also justified the policy of increasing the sterling and gold in the Reserve in *London* on two considerations :

(1) In the first place, it was reasonable that for the purchase of silver some part of the gold in the Paper Currency Reserve should be kept in London as the principal source of supply. For this purpose no great amount was required. (2) But there was the maintenance of exchange to be considered. ''The facts are,'' they said, ''that the gold in the Reserve in India has been much in excess of the demand, that the Gold Standard Reserve has not in itself been sufficient to secure beyond question the stability of exchange and the gold in London is more directly, and indubitably effective for this purpose than gold in India. In these circumstances, so long as the Gold Standard Reserve is insufficient by itself for the support of exchange, we think the policy is justified.''

### (B) Recommendations of the Commission.

With a view to giving greater *elasticity* to Paper Currency, the Majority recommended that (1) the fiduciary portion which stood at Rs. 14 crores should be increased at once to Rs. 20 crores. And thereafter it should be fixed at a maximum of the amount of notes held by Government in the Reserve Treasuries *plus* one-third of the net circulation ;

(2) Government should *take power to make temporary*

*investments or loans* from the fiduciary portion within this maximum in India and in London, as an alternative to investment in permanent securities. In India such loans should be made to the Presidency Banks on prescribed terms ;

(3) the 500-rupee note should be immediately universalized and facilities should be given for encashment.

THE ADVANTAGES CLAIMED :—They hoped for the following advantages from these recommendations :—

(1) "While the permanent addition to the invested portion of the Reserve will be no more than is justified by past practice and experience *without in any way endangering the complete convertibility of the notes,* the revenues of India will secure the profit earned by investing the amount now held idle in the form of gold in India."

(2) Then, there would be occasions, especially in the busy season, when it would be safe to lend temporarily sums which it would be unwise to invest permanently. The power to make such loans would, therefore, enable the Government to earn interest on sums which would otherwise be idle needlessly, and would provide at the same time a *much needed facility for a temporary expansion of the currency* in the busy season, by virtue of which the *market might obtain some relief,* though not at first, perhaps, a very great amount, from its currency stringency.

(3) Besides, the power to make temporary investments in London on account of the Paper Currency Reserve would be a convenience to the Secretary of State in permitting him to sell the Council Drafts against the Paper Currency Reserve, in anticipation of silver purchases or of

any other cause, without the loss of interest and other disadvantages, which might sometimes come about, if he were compelled, without discretionary power, to utilize the entire proceeds of such sales in ear-marking gold.

(4) As the circulation of notes in India increases, it would be within the power of the authorities to increase as and when desirable either in permanent or temporary investments of the Reserve or both without a special Act.

(5) The power to make loans from the cash held against notes in the Reserve Treasuries would provide the Government with a useful alternative or supplementary means of counteracting some of the disadvantages arising from the existing Reserve Treasury system.

*But before the recommendations could be put into force, the War broke out.*

## PERIOD III—Paper Currency during 1914 to 1919.

In the history of the rupee during War time, we traced the extraordinary difficulties which the Government had to face to meet the increased demand for silver coinage. In spite of the rise in the price of silver enormous quantities of silver had to be imported, but still the demand was unsatisfied.

### Greater elasticity.

The difficulty of obtaining sufficient quantities of the precious metals for coinage purposes, and as backing for the issue of additional notes, made it necessary to *increase the fiduciary (invested) portion of the Reserve.* By various Ordinances and Acts of the Legislature, the limits of securities were raised. Thus prior to the War, the in-

vested portion of the Paper Currency Reserve was limited by law to Rs. 14 crores. Between November, 1915, and December, 1919, *the legal limit of the invested portion was raised to Rs. 120 crores.*[1] By the Act XXVI of 1919, the invested portion of the Reserve was fixed at Rs. 120 crores of which Rs. 100 crores might be invested in British Treasury Bills. During the same period the gross circulation of notes increased nearly threefold, while the percentage of metallic backing decreased by nearly one-half.

The following table shows the growth of circulation and the changes in the composition of the Reserve :—

[1] Historical Memorandum submitted by Mr. A. C. McWatters, Finance Secretary to the Government of India, before the Royal Commission on Indian Currency and Finance, 1926. Para 7 of Volume II.

*(In lakhs of rupees.)*

| Date | Gross note circulation | Composition of Reserve | | | Total | Percentage of total metallic reserve to gross note circulation | Percentage of securities to gross note circulation |
|---|---|---|---|---|---|---|---|
| | | Silver | Gold | Securities | | | |
| 31st March, 1914 ... | 66,12 | 20,53 | 31,59 | 14,00 | 66,12 | 78·8 | 21·2 |
| Do. 1915 ... | 61,63 | 32,34 | 15,29 | 14,00 | 61,63 | 77·3 | 22·7 |
| Do. 1916 ... | 67,73 | 23,57 | 24,16 | 20,00 | 67,73 | 70·6 | 29·4 |
| Do. 1917 ... | 86,38 | 19,22 | 18,67 | 48,49 | 86,38 | 43·8 | 56·2 |
| Do. 1918 ... | 99,79 | 10,79 | 27,52 | 61,48 | 99,79 | 38·4 | 61·6 |
| Do. 1919 ... | 153,46 | 37,39 | 17,49 | 98,58 | 153,46 | 35·8 | 64·2 |
| 31st December, 1919... | 182,91 | 43,67 | 39,71 | 99,53 | 182,91 | 45·6 | 54·4 |

CONCLUSIONS :—The conclusions to be drawn from the above table are that :—

(a) the gross circulation of notes increased nearly threefold ;

(b) the *percentage* of metallic reserve to gross circulation fell from nearly 78 to nearly 45 ;

(c) the *percentage* of securities to gross note circulation increased from nearly 21 to nearly 54.

NOTES OF SMALLER DENOMINATIONS INTRODUCED :—To increase the note circulation the Government had to introduce notes of smaller denominations, and in 1917 the Rs. 2-8 note, and in 1918 the Re. 1 note were introduced, and these became very popular.

BRITISH TREASURY BILLS :—The increase in note circulation and the fact that owing to the large borrowing on the part of Great Britain during the war British Securities had depreciated, led to a change in investments. By the Act IV of 1916, investments were to be made in British Treasury Bills, as part of the Reserve, which being short-dated, were not likely to depreciate. Investments amounting to Rs. 6 crores were made in such bills and these were increased by successive Acts to Rs. 100 crores by the end of December, 1919.

DIFFICULTIES OF ENCASHMENT :—The encouragement given to the use of notes by providing ample facilities for their encashment had been a prominent feature of the currency policy in pre-war years, and this policy was continued as long as the supply of rupees was adequate. But the policy had to be reversed from 1916, owing to causes already indicated. Therefore facilities for the encashment of notes at district treasuries were in a large degree withdrawn. The conveyance of specie by rail or river steamer was prohibited, and an embargo

was placed on its transmission by post. Later, in January, 1916, owing to practical administrative difficulties of dealing in full with the demands for encashment at the Currency Offices during the busy season, the daily issues of rupees to single tenderers of notes were limited to a figure which made it practicable to satisfy large demands in part and small demands as a rule in full. The result of these restrictions was the substitution to a large extent of notes for rupees as the common circulating medium. The notes, as we have seen, were at a discount of as high as 19 per cent. in some places; but it rapidly diminished, when it was seen that notes were freely accepted in payment of Government dues and confidence was restored.

### PERIOD IV—Recommendations of the Babington-Smith Committee.

**(Greater elasticity to Note issue.)**

PROPOSALS FOR GREATER ELASTICITY :- The essence of the recommendations of the Majority of the Babington-Smith Committee was to give *greater elasticity to* note issue, and with that view they recommended :—

(1) that, instead of laying down that the invested portion of the Reserve must not exceed a fixed limit, the legislature should prescribe that "*it shall not exceed a maximum percentage of the total issue* (or alternatively, that the metallic portion shall not fall below a minimum percentage of the total issue)." By doing so "it would obviate the necessity for constant fresh applications to the legislature as the circulation grows." They recommended that the *fiduciary portion should not exceed 60 per cent. of the gross circulation;*

(2) that, with a view to meeting the seasonal demand for additional currency, it should be possible to issue 5 crores of notes over and above the normal fiduciary issue *as loans to the Presidency Banks on the security of export bills* having a maturity not exceeding 90 days. Such a device was already proposed by the Chamberlain Commission ;

(3) that the permissive maximum of 120 crores of securities should be retained for *a limited period.*

OTHER MAIN RECOMMENDATIONS :— They also recommended that the constitution and location of the Paper Currency Reserve should be as follows :—

(4) The holding of securities issued by the Government of India should not exceed 20 crores.

(5) The remainder of the fiduciary portion should consist of securities of other Governments within the British Empire, redeemable at a fixed date of which all except 10 crores should be short-dated securities maturing within one year.

(6) The metallic portion of the Reserve should be held in India except for transitory purposes.

## PERIOD V—1920 to 1925.

PAPER CURRENCY RESERVE USED TO STRENGTHEN EXCHANGE :—We saw that in March, 1920, in view of the large sales of the Reverse Councils which the Secretary of State was unable to meet entirely from his Treasury Balances, he was compelled to sell out *sterling securities* in the Paper Currency Reserve. In the absence of any special legislation permitting increased investments in Indian securities, it would have been necessary to cancel notes to the full value of the sterling securities sold.

ACT XXI OF 1920 :—As such action would have caused a serious monetary crisis in India, temporary legislation was passed in March, 1920, continuing the then existing figure of Rs. 120 crores as the limit of permissible investment, but *abolishing the restrictions as to the location of the investments and their sterling or rupee character.*[1] This act remained in force up to the 1st October of the year, when it was replaced by the Indian Paper Currency Amendment Act (No. XLV of 1920).

INDIAN PAPER CURRENCY AMENDMENT ACT (NO. XLV) :—This Act practically gave effect to the recommendations of the Babington-Smith Committee regarding the eventual statutory constitution of the Paper Currency Reserve, while providing for a temporary transitional period of adjustment. The Act provided, in the first place, for the issue of currency notes against Sovereigns and half-Sovereigns at the new rate of Rs. 10 per Sovereign and against gold bullion at the corresponding rate of one rupee for 11.30016 grains troy of fine gold. In the second place, it provided for (1) a permanent and (2) a temporary constitution.

ITS PERMANENT CONSTITUTION :—The object of the permanent constitution was to obviate the necessity for constant applications to the Legislature to give elasticity to the Paper Currency and to give it thereby an *automatic elasticity*. The *permanent* constitution of the Reserve was as follows :—

(a) The metallic portion of the Reserve was to be *not less than 50 per cent.* of the currency notes in circulation (instead of 40 per cent. as recommended by the Babington-Smith Committee). In other words, *the in-*

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[1] Historical Memorandum submitted by Mr. A. C. McWatters before the Hilton-Young Commission.

*vested portion of the Reserve was not to exceed the value of the metallic reserve.* The gold held by the Secretary of State shall not exceed Rs. 5 crores.

(b) As regards the Securities in the Reserve, it was provided that the Government of India Securities *shall not exceed Rs. 20 crores.* Not more than Rs. 12 crores of this amount may be in Securities *'created'* by the Government of India.

(c) Notes to be issued against commercial bills of exchange, maturing within 90 days from their date of issue, were *not to exceed* Rs. 5 crores. This permanent constitution was to be brought into force as soon as the metallic portion was equal to 50 per cent. of the currency notes in circulation as in (a). During the intermediate period the Act provided for a temporary constitution.

ITS TEMPORARY CONSTITUTION :—Under its temporary constitution : (1) the securities of the Government of India held in the Reserve were limited to Rs. 85 crores, and (2) the gold and the sterling securities were to be revalued on the basis of Rs. 10 per sovereign instead of Rs. 15.

THE "CREATED SECURITIES." :—Hence, in revaluation there would be great loss and a great reduction in the amount of the Reserve. The difference was, therefore, to be made good by the issue of a special creation of Government of India Securities. These came to be known as *"created securities."* [1] The limit set by the Act on the issue of these 'created securities' was Rs. 12 crores. But by the revaluation of the Reserve this limit was to be exceeded considerably. Therefore, it was enacted that as long as the 'created securities' exceeded Rs. 12 crores all interest derived from the securities in

[1] Also called "ad-hoc" securities.

the Reserve was with effect from the 1st April, 1921, to be applied in reduction of such excess holdings. The interest on securities held in the Gold Standard Reserve was also to be utilized for the same purpose when the Reserve reached £40 millions. Thus, by the help of the 'created securities' it was expected that within a few years the loss due to revaluation would be made up and the permanent provisions of the Act would be brought into effect.

However, during the years that followed, the provision of utilizing the interest on securities in the Reserve towards reduction of 'created securities' was suspended and the interest was taken to revenue.

As a result of the passing of the Act, the gold and the sterling securities held in the Paper Currency Reserve were revalued on 1st October at the new rate of Rs. 10 per sovereign. The deficiency in the Reserve resulting thereby was made up by 12 months' Treasury Bills of the Government of India issued to the Reserve.

CONTRACTION OF CURRENCY AND EMERGENCY CURRENCY (1921-24.) :—We have referred to the contraction of Currency in 1921 and 1922 for strengthening exchange, and to the issue of emergency currency to the extent of Rs. 24 crores to relieve the undue monetary stringency during 1923 and 1924 (see pages 135 and 136).

CONDITIONS GOVERNING ISSUE OF EMERGENCY CURRENCY :—The conditions laid down for the issue of emergency currency against Bills of Exchange were that—

(1) loans shall be given to the Imperial Bank of India only when the Bank rate rises to 6 per cent. and not below it, and that

(2) when the bank rate is below 7 per cent. a maximum of 4 crores should be issued; second 4 crores when the bank rate is 7 per cent., and last 4 crores when the bank rate is 8 per cent.

But in September, 1924, an announcement was made changing the rules under which loans were made to the Imperial Bank of India from currency so as to make it possible for the Bank (1) to borrow 4 crores when the rate is at 6 per cent. and (2) 8 crores when the Bank rate is at 7 per cent., instead of 4 crores at each rate from 6 to 8 per cent.

PAPER CURRENCY AMENDMENT ACT OF 1925 :—In view of the possibility of a greater demand for additions to circulation in the future, the Indian Paper Currency Act was amended in February, 1925, which gave authority to increase the permissible limit of the holding of securities in the Reserve from 85 to 100 crores provided that the total amount of "created securities" of the Government of India shall not exceed 50 crores.

THE SITUATION IN SEPTEMBER, 1925 :—The situation in September, 1925, was as follows :—

*(In lakhs of rupees)*

| Gross note circulation | Percentage of metallic reserve to gross note circulation | Percentage of securities to gross note circulation |
|---|---|---|
| 189·51 | 59·3 | 40·7 |

## PERIOD VI—Recommendations of the Hilton-Young Commission, 1926.

We now take up the recommendations of the Hilton-Young Commission with regard to Note issue and Reserve requirements. Before making any definite sug-

gestions in these respects, they, in the beginning, lay great stress on the importance of the stability of the purchasing power of the monetary unit, which could be obtained through the control on currency regulation by the proposed Reserve Bank of India.

STABILITY OF THE MONETARY UNIT :—
The principal task of the Central Bank is the achievement of stability of the purchasing power of the monetary unit.

This stability takes two forms :—

(a) the stability internal *i. e.* the general level of commodity prices ;

(b) the value of the monetary unit in relation to gold externally.

But we ask, what is the machinery which will enable the proposed Reserve Bank to undertake this obligation of achieving stability?

It is a two-fold business :

(1) The sole right of the note issue is to be given to the Bank, and also (2) the power to impose upon the country a judicious credit policy.

These two functions will give the bank the means to control the volume of monetary circulation in India.

(1) *Internal* stability of the value of the monetary unit can only be brought about by limiting the monetary circulation to the actual needs of the country. But this postulates contraction and expansion of the currency according to those needs, and in India, a mainly agricultural country, these needs fluctuate widely. Therefore, the mechanism needs to be controlled very accurately and carefully. But, if the paper currency is to be issued by the bank when there is need for expansion, they should be secured by assets which would be suitable, *i. e.* the *assets* should be of such a nature that when they are mature they could

be *liquidated,* when the increased monetary circulation is no longer needed.

The true *commercial bill* is the best asset possible, for whenever money is to be withdrawn, it could be sold off. It is self-liquidating, and whenever currency is to be expanded, the bill could be bought by the Government. This then was recommended by the Commission as an asset, and it is the use of these bills as assets that would bring stability to the purchasing power of the monetary unit internally. Government of India securities were also suggested as the assets, although they are far less desirable than commercial bills.

(2) Internal stability is the main factor to achieve *external* stability. In spite of this, it is essential that the note issue should be secured to a substantial extent by assets which are capable of rectifying a temporary disequilibrium in the foreign balance of payments. Such a disequilibrium is bound to occur from seasonal causes or bad harvest or financial stringency. *Gold and gold securities* are the assets most suitable for this purpose, for they can be readily employed to discharge external liabilities.

### The system of note issue suited to India.

The Commission suggested two systems of note issue to choose from :

I. Fixed Fiduciary System.
II. Proportional Reserve System.

### (i) Fixed Fiduciary System.

The Fixed Fiduciary System has been adopted by England under its Bank Charter Act of 1844. Its essential features are the following :—

(*a*) The Bank of England is authorized to issue its own notes *on the security of Government debt* to an amount fixed by statute.

(*b*) But any additional notes over and above this fixed fiduciary limit have to be secured by a gold backing of 100 per cent.

(*c*) The business of note issuing and banking is separated by law into separate departments called the 'Issue Department' and the 'Banking Department'.

(*d*) The Reserve held in the form of notes that are created, but not actually put into circulation is held by the banking department as a reserve. The size of this reserve constitutes the limit to which the currency can be expanded.

(*e*) If more currency is needed, as for instance in a severe crisis, nothing remains *but to suspend the Bank Act*. This has actually happened three times in its history.

After nearly 84 years of the working of this Act it was amended in 1928 by the Currency and Bank Notes Act. This new Act has two important features :—

(a) it has authorized the Bank of England to issue its notes against securities to an amount of £260,000,000, *i. e.* the fiduciary limit has been increased considerably ;

(b) it has empowered the Bank to *increase this fiduciary limit* by the sanction of the *Treasury*, immediately communicated to Parliament. But this the Bank could only do for a period not exceeding six months ; and it may be renewed for the next six months, provided that no fiduciary circulation shall exist for more than two years without the express sanction of Parliament.

By this Act then the Fixed Fiduciary System has been continued but it is made elastic by the provision of a simpler and quicker method of getting the sanction of the Treasury in the first instance, instead of the crude method of suspending the Bank Act.

ADVANTAGES OF THE SYSTEM :—Thus, under this system it is rightly laid down that (1) there is a minimum of currency always remaining in circulation unless the mechanism of exchange should break down completely ;

(2) so long as the currency is issued up to the maximum limit, there is no danger of the purchasing power of money being adversely affected ;

(3) under this system, the expansion and contraction of note issue beyond the fixed fiduciary limit takes place at a rate exactly equal to the increase or decrease of the gold reserve. *Hence this system brings security at the expense of elasticity.*

However, elasticity (or expansion and contraction) of currency in England takes place through the cheque system of the very highly organized banking system of that country.

**(ii) Proportional Reserve System.**

The Proportional Reserve System is in operation in many of the countries on the continent of Europe, the United States of America under the Federal Reserve system, and in South Africa. Its essentials are that—

(1) It does not require the note issuing and banking functions to be separated into two different departments.

(2) Under it, notes in active circulation are secured by a minimum percentage of gold and gold securities which is laid down by law, and which is 40 per cent. in the case of America.

(3) These minima are not rigidly fixed but may be transgressed with the consent of the Government for *short periods* on the condition that the issuing bank pays the tax reckoned on the amount of the deficiency. The tax is made to rise as the deficiency increases.

ITS GREAT ADVANTAGES :—Its chief characteristic is that expansion and contraction do not take place at the same rate as the gold reserve is increased, or decreased, but that it permits expansion, and forces contraction to take place in the proportion of 100 : 40. Thus, an addition of 40 units to the gold reserve permits the bank to issue the notes to the amount of 100 units ; conversely, a loss of reserve of 40 units forces a contraction of notes to the extent of 100 units.

Thus, the great virtue of this system is its *great elasticity*. At the same time security is not sacrificed, for expansion above a limit is permitted for short periods only, and that a steeply rising tax forces the bank to take prompt measures to redress the situation.

But this system is not suited to a country like England which in practice *has maintained an absolutely free gold market*. Suppose, for instance, the ratio of gold to notes is fixed at $33\frac{1}{3}$ : 100 and that it is actually operative. If a withdrawal of gold for export takes place and thereby reduces the proportion below the prescribed limit, it would be necessary to withdraw notes in the ratio of 3 : 1. This would have the effect of causing violent contraction of currency and thereby great disturbances in the money market of the country. Such a danger then constantly exists in this system as applied to a country like England which is exceptionally subject to very large gold drains.

**Proportional Reserve System for India.**

The Commission proposed the Proportional Reserve System for India, but with the departments separated. They based their conclusions on the following reasons.

Joint-Stock Banking and the use of the cheque as currency are already developing in India, but they can hardly

be expected to develop sufficiently quickly to mitigate the rigidity of the Fixed Fiduciary Issue System.

Besides, India needs an elastic system. The need for seasonal expansion and contraction for India is particularly pronounced owing to the mainly agricultural character of its internal economy. And complaints have often been made that the Indian Paper Currency has been made unduly rigid, and that it creates stringency.

The separation of the Departments was suggested in view of the fact that many witnesses urged that the accounts of the Bank should be kept in the simplest possible form. This would inspire greater confidence in the new note. On these lines, therefore, they outlined a charter by which the Reserve Bank will have the sole right to issue notes for a period of 25 years. Its notes will be legal tender and will eventually replace Government notes.

THE RESERVE :—In the light of the experience of other note issuing Banks which are working this system, the Commission recommended the provision of *the gold and gold securities* in the Reserve *to be not less than 40 per cent. of the liabilities as a minimum.* The liabilities include the notes in issue plus Rs. 50 crores (set aside as provision against conversion of the hoarded rupees into gold).

The effect of the Commission's proposals on the constitution of both the Paper Currency Reserve and the Gold Standard Reserve *in the aggregate*[1] will be, in short, as follows :—

(*a*) *Liabilities of the Bank* :—The Liabilities of the Bank will consist of Rs. 185 crores of Notes issued (future liabilities

[1] The Majority recommended the unification of the two Reserves and a fixed proportion and composition of the combined Reserve. We shall deal with it in the next chapter.

will be increased by the full amount of further note issues), and Rs. 50 crores set aside as provision against conversion of hoarded rupees into gold;

(b) *Assets of the Bank*:—The Assets of the Bank will consist of—

(1) gold and gold securities which will in all be 40 per cent. of liabilities (minimum) *from outset*. But *gold* will *eventually* be 25 per cent. of liabilities (minimum), this limit to be attained by stages in 10 years, with a *minimum* (over-riding) *of 30 crores;*

(2) rupee securities which will be not more than 25 per cent. of liabilities, with *a minimum* (over-riding) *of 50 crores;*

(3) rupee coins for which a maximum limit is prescribed. The Scheme contemplates no statutory obligation upon the Reserve Bank to convert its own notes into rupee coins. But a reasonable amount of rupees should be kept in order to meet the wants of the public.

## PERIOD VII—1927-1931.

As stated in Chapter VII, the only concrete result of the Report of the Hilton-Young Commission was the passing of the Currency Act, 1927. It amended the Indian Paper Currency Act 1923, under which the rupee was valued at the rate of *2s*. The new Act amended it and valued the rupee at the new rate of *1s. 6d*. This was the only constitutional change made as regards the Paper Currency System.

Besides, as stated previously, the Commission had recommended a substantial reduction of the silver holding of the Paper Currency Reserve which they found excessive. Following up this recommendation the Government of India sold silver during these years. In view of this it is necessary to know what changes took place in the Reserve.

## *Composition of the Paper Currency Reserve.*

*( In lakhs of rupees. )*

| Date (on 31st March of) | Gross Note Circulation | Composition of the Reserve | | | | | |
|---|---|---|---|---|---|---|---|
| | | Coin and Bullion | | | | Securities | |
| | | In India | | | In England | In India | In England |
| | | Silver Coins | Gold Bullion | Silver Bullion | Nil | | |
| 1927 | 1,84,13 | 95,94 | 22,32 | 8,53 | ,, | 51,77 | 5,57 |
| 1928 | 1,84,87 | 98,72 | 29,76 | 7,66 | ,, | 37,96 | 3,77 |
| 1929 | 1,88,03 | 94,94 | 32,22 | 4,95 | ,, | 43,23 | 10,69 |
| 1930 | 1,77,23 | 1,08,11 | 32,27 | 2,85 | ,, | 33,85 | 15 |
| 1931 | 1,60,84 | 1,17,86 | 25,85 | 6,94 | ,, | 10,19 | Nil |

CONCLUSIONS DRAWN : — The conclusions drawn from the table are that *as compared with 31st March 1927,*

(i) the gross note circulation fell by nearly 12 per cent. on 31st March, 1931 ;

(ii) the silver coinage increased by 23 per cent. but the holding of silver bullion decreased by nearly 18 per cent. on 31st March, 1931 ;

(iii) the *total gold resources* (gold and sterling securities) on 31st March, 1931, fell by nearly 30 per cent. (when these resources were valued on March, 1927, at 1*s.* 6*d.* ratio).

Besides, on 31st March, 1927, the gold assets formed 20 per cent. of the gross note circulation, but on 31st March, 1931, they formed 15 per cent. of the gross note circulation.

*Total gold resources* :—However, as there is still no clear demarcation made between the functions of the two

Reserves, the resources of the Gold Standard Reserve may be added to those of the Paper Currency Reserve in order to arrive at the total strength marshalled to support the note circulation. If this were done, the total resources amounted on 31st March, 1931, to nearly Rs. 78,09 lakhs or *nearly 48 per cent. of the outstanding note issue as against the same percentage* on 31st March, 1927 (the gold resources being valued at 1*s*. 6*d*.).

# CHAPTER X.

## History of the Gold Standard Reserve.

The history of the origin and growth of the Gold Standard Reserve has already been traced in Chapters III and IV. Here a summary will be sufficient.

### SECTION I—**Its origin and reasons for its creation.**

#### Its origin and original purpose.

The Gold Standard Reserve was established in 1900, but it had its origin in the recommendation of the Fowler Committee, that the profits on the coinage of rupees should be set apart and *kept in gold as a special reserve in India* (Page 63). The principle use of the gold reserve suggested by them was that "*it should be freely available for foreign remittance whenever the exchange falls below specie-point;* and the Government of India should make its gold available for the purpose, when necessary, under such conditions as the circumstances of the time may render desirable. For example, the Government of India might, *if the exchange showed a tendency to fall below specie-point, remit to England a portion of the gold* which it may hold, a corresponding *reduction* being made in the drawings of the Secretary of State; and when it has accumulated a sufficient gold reserve, and so long as gold is available in its Treasury, it might discharge its obligations in India in gold, instead of in rupees."

Thus, the essentials were two: (1) gold so accumulated should be kept in *India,* and (2) it should be made *freely available* for foreign remittances in case of an adverse balance of trade.

(A) THE METHOD OF STRENGTHENING EXCHANGE :—But as soon as the Reserve was established, the profits on coinage were remitted to *London* and *invested in securities,* and since then, although the original purpose remained the same, *the method of performing its function changed.* Thus, if the balance of trade goes *against* India and the exchange value of the rupee threatens to fall below specie-point, a two-fold process is resorted to :

(a) the Secretary of State stops for a time the sale of Council Bills in *London,* and thereby *prevents any additions being made to the rupee circulation in India,* because no Bills would have to be paid from the Indian Treasuries and rupees would not go out of it into circulation. But if the Secretary of State needs funds for various expenses at this time, he could fall back on the Gold Standard Reserve.

(b) *At the same time,* the Government of India would sell the *Reverse Councils in India on London.* The effect of doing this would be that, as these are bought and paid for by the public, money would tend to be withdrawn from circulation.

Thus, by action (a) addition to currency circulation is prevented, and by action (b) currency is withdrawn from circulation, *i. e.* currency is *contracted,* and as a consequence, *the exchange value of the rupee tends to rise.*

(B) LIQUIDATING INDIA'S UNFAVOURABLE BALANCE OF TRADE :—But when the balance of trade becomes unfavourable to India, the method of liquidating it is by the sale of the Reverse Councils by the Government of India. Importers of foreign com-

modities would thus get an easy method of paying for their indebtedness. They would buy these Councils to the extent of their debt and pay for them in *rupees in India,* whereas their creditors in England would, on presentation of these Councils which they receive from the debtors in India, be paid in gold by the Secretary of State from the *Gold Standard Reserve.*

(C) TO MEET THE HOME CHARGES :—Besides, when the Balance of Trade becomes unfavourable to India, the sale of the Council Bills in London would be automatically reduced, because the need for remittance of money to India to pay for commodities bought becomes reduced. The Secretary of State would, under these circumstances, meet the "Home Charges" from the Gold Standard Reserve.

## SECTION II—Amount, Composition and Location of the Reserve.

(See pages 69-76)

HISTORY UP TO 1913 :—We saw that the Reserve was first established in 1900 on the recommendation of the Fowler Committee, and that the minute of Sir Edward Law laid the basis of the Gold Exchange Standard and the formation of the Gold Standard Reserve. But although the Government of India favoured the establishment of the Reserve in gold in India, the Secretary of State decided that the profits on coinage of rupees should be remitted to London and invested in sterling securities. Thereafter the same policy was pursued.

In 1906, however, came a change. The difficulty in meeting the demands for rupees led to the formation in India of a *special reserve* for this purpose outside the Paper Currency Reserve. This Reserve was to be in

coined rupees and was to form a part of the profits on the coinage of rupees. Thus, two branches of the gold reserve were formed : (1) the London Branch and (2) the Indian Branch in form of Rupees. The name of this Reserve was changed to the *Gold Standard Reserve.*

We also saw that the Mackay Committee recommended the utilization of £1 million from the Gold Standard Reserve for capital expenditure on railways. But the Secretary of State, in spite of protest from the Government of India, actually diverted £1,123,000 towards railway capital.

But the serious crisis of 1907-8 made the Secretary of State change his decision. The Gold Standard Reserve was very hard hit by this crisis. In all £8,058,000 was withdrawn from the Reserve to meet the Reverse Councils sold for strengthening the exchange value of the Rupee (see pages 76-80).

During 1909-13, the Government of India pleaded for a *larger Gold Standard Reserve* to meet greater emergencies than that of 1907-8. They considered that the minimum amount should be £25 millions and that a substantial part of it should be in a *liquid form,* instead of being invested in securities. But although the Secretary of State reluctantly agreed to the suggested minimum, he would not agree to keep a substantial part of it in a liquid form, except for the amount of £1 million which was to be let out on short loans or put into Bank deposits.

The total amount of the Gold Standard Reserve on 31st March, 1913, was £22,571,333 and was composed as follows :—

| Date | Golddeposited at the Bank of England | Silver in Indian Branch (Rs. 6 crores at 1*s.* 4*d.*) | Securities (at market price) | Money lent at short notice |
|---|---|---|---|---|
| 31st March 1913 | £ 1,620,000 | £ 4,000,000 | £ 15,945,669 | £ 1,005,664 |

**Recommendations of the Chamberlain Commission.**

Such was the situation when the Chamberlain Commission was called upon to make recommendations.

(a) *As regards the amount of the Reserve* :—They analysed in the beginning the purpose for which the Reserve was needed. Not merely was it required for meeting the "Home Charges" of the Government of India when an adverse rate of exchange prevented the free sale of the Council Drafts, but also to liquidate an unfavourable balance of trade to the extent necessary to prevent the exchange from falling below the specie-point. "On the other hand," they wrote, "the Reserve is not required to provide for the conversion into sovereigns of the rupees in circulation in India. It is true that the Reserve is built up out of the profits on the coinage of rupees, but its object is not to secure the convertibility on demand of the whole of the rupees in circulation, but only to provide a reserve sufficient to convert into sterling such amount of rupees as may at any moment seek export ; in other words, such amount as the owners require to exchange for sterling in order to settle debts due in sterling."

This being the purpose of the Reserve, its amount depended upon *the growth of India's trade,* and the extent of the deficiency that adverse seasons and circum-

stances were likely to produce. One of the most noticeable features in the crisis of 1907-8 was the fact that, for some time after the crisis had declared itself, imports from abroad, ordered in advance in times of prosperity, continued to pour into India, thus accentuating the adverse conditions resulting from the failure of the crops and the consequent falling off in the volume of exports. Even in such a case the balance would restore itself in course of time, but in the meantime exchange would have collapsed. "It is to maintain exchange in the interval before the balance of trade can right itself that the Reserve exists, and *its resources must be sufficiently liquid to be used at onde and sufficiently large* to meet the most prolonged strain to which it may reasonably be anticipated that they might be exposed."

The extent of the resources needed to meet an adverse balance of trade could not be determined with accuracy and the *Majority did not attempt* to lay down any *hypothetical limit* beyond which additions to the Reserve should cease. But they expressed the opinion that the suggested limit of £25,000,000 was insufficient, and that the profits on coinage of rupees should be credited exclusively to the Reserve.

(b) *As regards the composition of the Reserve*:— They recommended that (1) a much larger portion of the Reserve than the suggested total should be held in actual *gold*. They feared that the enforced realization of securities in large quantities during a crisis might involve a heavy loss in capital value, and if, the exchange crisis in India (which makes such realization necessary) would be accompanied or directly caused by a financial crisis in London or reacted upon London, the difficulty of realization would be intense and the loss severe.

"India should," they wrote, "in this respect, be as far as possible independent of London."

(2) By an exchange of assets between this Reserve and the Paper Currency Reserve, a total of about £10,000,000 in gold could be at once secured.

This total should be raised, as opportunity offered, to *£15,000,000,* and thereafter the authorities should aim at keeping *one-half of the total Reserve in actual gold.*

(3) The Indian Branch of the Reserve in which rupees were held should be *abolished,* the rupees being handed over to the Paper Currency Reserve in exchange for gold.

(c) *As regards location of the Reserve* :—The Majority recommended that the most suitable place for the location of the Reserve was London. Their reasons were that "London is the clearing-house of the world. India's chief customer is the United Kingdom, and London is the place where money is required both for the expenditure of the Secretary of State on India's behalf and for payment of India's commercial obligations to this country and the world in general. If the Reserve were kept in India, it would have to be shipped to London to be used. This would involve delay at a moment when immediate action is essential."

POSITION BETWEEN 1914-1919 :—The recommendation of the Chamberlain Commission that the silver branch of the Gold Standard Reserve, which in June, 1914, amounted to 6 crores of rupees, should be abolished, was given effect to in 1915. And the policy with regard to the composition of the Reserve during and after the War was of holding it chiefly in sterling securities. The following figures show its composition at different times :—

*£ millions (nearly)*

| — | 1913 (March) | 1917 (March) | 1919 (30th November) |
|---|---|---|---|
| *Metallic Portion* | | | |
| Gold—(1) In India ... ... | ... | 1 | ... |
| (2) In England ... | 1½ | ... | ... |
| Silver in India ... ... ... | 4 | ... | ... |
| *Invested portion.* | | | |
| (1) Securities ... ... | 16 | 25 | 37½ |
| (2) Money lent at short notice ... | 1 | 6 | *27 (thousand only)* |
| Total ... ... | 22½ | 32 | 37½ |

Thus, by November, 1919, the Reserve was held *entirely in securities*. The increase in total composition of the Reserve was due to the increase in the coinage of rupees, consequent on the heavy demand for silver coins during the War. Apart from the policy of not keeping the Reserve in gold, its disappearance may also be traced to the difficulty of obtaining gold during these years.

**Recommendations of the Babington-Smith Committee.**

The Majority of the Babington-Smith Committee pointed out that, if a sudden fall in world prices took place, it might adversely affect Indian trade, in which case a heavier call might be made on the resources for supporting exchange than had occurred in the past. They, therefore, held that *no limit could be fixed* to the amount of the Reserve.

(1) But profits on the coinage of rupees should be credited in entirety to the Reserve.

(2) They also agreed in principle that the Reserve should *contain a considerable proportion of gold*. But as the conditions were not favourable to obtaining gold, and there was great necessity for gold to support the notes, they recommended that the most satisfactory course would be to keep the Reserve *as liquid as possible* by an ample holding of securities with *early dates of maturity*. The amount of securities in the Reserve with a maturity exceeding three years should not be increased. The authorities should aim at holding all the invested portion of the Reserve in securities issued by Governments within the British Empire (other than the Government of India), and having a fixed date of maturity of *not more than 12 months*.

(3) Besides, as there was a strong sentiment in India in favour of the location of the whole, or at any rate a large part, of the Reserve in India, and as they considered the possession of public confidence as an asset of great value in currency matters, they considered that a portion of the Reserve should be held *in India*; but the *gold so held should not exceed one-half of the total,* and steps should be taken to ensure that it was not made available to the public except for the purpose of export.

(4) The sterling investments of the Reserve (including cash on deposits) should, as in the past, continue to be held in London.

THE RESERVE BETWEEN 1920-25:—Then followed the disastrous period which ended in September, 1920, during which the Government sold £55,382,000 of Reverse Councils; but these were paid in London out of the sterling securities and Treasury Bills belonging to

the Paper Currency Reserve. The Gold Standard Reserve remained untouched.

In 1921 it was decided to utilize the interest on the securities in the two Reserves for reduction of the "created securities" held in the Paper Currency Reserve.

During the period of the abandonment of the attempt to stabilize the rupee, the Reserve steadily accumulated until on 30th September it exceeded £40 million. Later in July, 1923, in view of the existence of a wide range of British Government Securities, it was decided that while the Reserve aggregated £40 million, £30 million should be held in securities not exceeding two years' maturity, and the rest in securities not exceeding 10 years. But later, it was decided that of the £40 million, £20 million should be in securities not exceeding 2 years' maturity, £10 million in securities not exceeding 10 years, and £10 million in securities not exceeding 5 years.

The composition of the Reserve on 31st July, 1925, was as follows :—

| Location | Amount |
|---|---|
| *In England*— | £ |
| British Government Securities . | 40,419,244 |
| Cash at the Bank of England . | 514 |
| In India ... ... ... | Nil |
| Total ... | £40,419,758 |

**Recommendation of the Hilton-Young Commission.**

In analysing the defects of the existing system of currency the Majority of the Hilton-Young Commission pointed out the weaknesses in the management and func-

tions of the Reserves (pages 140-141). The two main defects pointed out as regards the Gold Standard Reserve were that :

(1) there was no clear line of demarcation between the purposes for which the Paper Currency Reserve and the Gold Standard Reserve are respectively utilized. Thus, while the original function of the Gold Standard Reserve was to maintain the external value of the silver rupee, its use operated to some extent in maintaining the external value of the notes.

(2) "*Besides, the amount of the Gold Standard Reserve and the time and manner of its use were wholly within the discretion of the Government.* The Gold Standard Reserve being built out of the profits of coinage, the amount actually carried to the Reserve depended on the price at which the silver was purchased and not upon the liabilities outstanding. Any estimate of the amount of the outstanding rupee circulation was largely conjectural ; it might be estimated at 350 to 400 crores, against which the Reserve held at present was only $53\frac{1}{3}$ crores. It was true that a portion of the Reserve against the silver rupee was carried in the coin itself (in the shape of its bullion value) but, it was admittedly difficult to make any immediate use of the metallic contents of the silver rupees at the time when those rupees were seeking conversion into sterling."

UNIFICATION OF THE RESERVES :—The Majority, therefore, recommended the *unification* of the Paper Currency and the Gold Standard Reserves, and proposed that *the proportions and composition of the combined Reserve should be fixed by statute.* We have already given the proposed constitution of the Reserve in the preceding Chapter.

THE RESERVE DURING 1927-31 :—As stated previously, the passing of the Currency Act, 1927 has brought about no change in the Gold Standard Reserve. Consequently, its composition has practically remained the same. This is shown in the following Table :

## *Gold Standard Reserve*

*(on 31st March of each year.)*

| | 1927 | 1928 | 1929 | 1930 | 1931 |
|---|---|---|---|---|---|
| I. Sterling Securities | £ | £ | £ | £ | £ |
| (estimated value) | 38,269,683 | 37,843,638 | 37,844,624 | 37,843,918 | 31,599,381 |
| II. Gold | 1,730,134 | 2,152,334 | 2,152,334 | 2,152,334 | 2,152,334 (in England) 6,247,200 (in India) |
| III. Cash at the Bank of England | 183 | 4,028 | 3,042 | 3,748 | 1,085 |
| TOTAL | 40,000,000 | 40,000,000 | 40,000,000 | 40,000,000 | 40,000,000 |

# CHART ILLUSTRATING HISTORY OF INDIAN CURRENCY AND EXCHANGE

## Currency History during Nineteenth Century.

- Before 1835 (Two standard coins.)
- 1835-1893 (Consequences of a fall in price of silver.)
  - Part I. 1835-1874 (Demonetization of gold.)
    - (A) 1835-1870.
      - (*i*) Demonetization of gold.
      - (*ii*) Attempt at introduction of gold.
    - (B) 1870-1874.
      - Gold not legal tender.
  - Part II. 1874-1893 (Falling and unstable exchange.)
    - (A) 1874-1878.
      - Rapid fall in price of silver.
    - (B) 1878-1892.
      - (The Remedies?)
    - (C) 1892-1893.
      - (*i*) Herschell Committee's Report.
      - (*ii*) *Closing the mints to free coinage of silver.*
- 1893-1900.
  - Section I.
    - Act of 1893.
      - Closing the mints to silver and gold.
  - Section II.
    - 1893-1895.
      - Continued fall of silver.
  - Section III.
    - 1895-1899.
      - Raising the rate to 1*s.* 4*d*.
  - Section IV.
    - Report of Fowler Committee and *Gold Currency for India.*

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## Currency History during Twentieth Century (up to 1931).

- Pre-War Period.
  - 1900-1907.
    - Drifting towards the Gold Exchange Standard.
  - 1907-1914.
    - Part I.
      - Crisis of 1907-08 (Its lessons.)
    - Part II.
      - 1909-1913. (Currency Policy?)
    - Part III.
      - *Report of the Chamberlain Commission.* (The Gold Exchange Standard.)
- War Period.
  - Up to end of 1916.
    - Dislocation of trade and business.
  - 1917 to end of the War.
    - *Extraordinary rise in the rate of exchange.* (Its consequences.)
- *Post-War Period.*
  - *Period I.* The year 1919.
    - Report of the Babington-Smith Committee. (*The 2 s. Gold Ratio.*)
  - *Period II.* 1920 to March 1921.
    - (*Consequences of* the 2*s.* Gold Ratio.)
  - *Period III.* March 1921-1925. (Condition of Exchange.)
  - *Period IV.*
    - 1926-1927.
      - Report of the Hilton-Young Commission.
        - (*The Gold Bullion Standard.*)
  - *Period V.*
    - 1927-1931.
      - The Currency Act, 1927.
        - (1*s.* 6*d.* Ratio.)